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ABSTRACTS

Identity and Persuasion

How Nations Remember Their Pasts and Make Their Futures

By CONSUELO CRUZ

Identity struggles are once again a salient problem in world politics. This article aims to throw light on the sources, dynamics, and consequences of identity formation and mobilization. It makes two theoretical arguments. First, because collective memory is both a seemingly factual narrative and a normative assessment of the past, it shapes a group's intersubjective conceptions of strategic feasibility and political legitimacy. This is why collective identity is above all an expression of normative realism: a group's declaration to itself and to others about what it can or cannot do; what it will or will not do. Second, at critical junctures competing actors assert or contest the normative realism underlying collective identity. They do this through rhetorical politics, deploying their powers of persuasion in order to engage the constitutive elements of the group's shared identity. In practical terms, rhetorical politics is structured by a dominant frame: a historically shaped discursive formation that does two things. It articulates in readily accessible ways the fundamental notions a group holds about itself in the world and allows or disallows specific strategies of persuasion on the basis of their presumptive realism and normative sway. Within this frame, rhetorical politics engenders a *collective field of imaginable possibilities:* a restricted array of plausible scenarios about how the world can or cannot be changed and how the future ought to look. Though circumscribed, this field is vulnerable to endogenous shifts, precisely because actors' rhetorical struggles introduce conflicts over the descriptive and prescriptive limits of what is "realistically" possible. Such conflicts may in fact produce a new dominant rhetorical frame and profoundly influence a nation's political and economic development. Two contrasting cases from Latin America offer empirical support for these arguments. The article shows that the sharp developmental divergence between Costa Rica and Nicaragua can be properly understood only through close analytical scrutiny of the different rhetorical frames, fields of imaginable possibilities, and collective identities that rose to prominence at critical points in these countries' colonial and postcolonial histories.

The Causes of Welfare State Expansion

Deindustrialization or Globalization?

By TORBEN IVERSEN and THOMAS R. CUSACK

An influential line of argument holds that globalization causes economic uncertainty and spurs popular demands for compensatory welfare state spending. This article argues that the relationship between globalization and welfare state expansion is spurious and that the engine of welfare state expansion since the 1960s has been deindustrialization. Based on cross-sectional-time-series data for fifteen OECD countries, the authors show that there is no relationship between globalization and the level of labor-market risks (in terms of employment and wages), whereas the uncertainty and dislocations caused by deindustrialization have spurred electoral demands for welfare state compensation and risk sharing. Yet, while differential rates of deindustrialization explain differences in the overall size of the welfare state, its particular character—in terms of the share of direct government provision and the equality of transfer payments—is shaped by government partisanship. The argument has implications for the study and the future of the welfare state that are very different from those suggested in the globalization literature.

Wage Inequality and Varieties of Capitalism

By DAVID RUEDA and JONAS PONTUSSON

This article draws on a new data set that enables the authors to compare the distribution of income from employment across OECD countries. Specifically, the article conducts a pooled cross-sectional time-series analysis of the determinants of wage inequality in sixteen countries from 1973 to 1995. The analysis shows that varieties of capitalism matter. The authors find that the

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qualities that distinguish social market economies from liberal market economies shape the way political and institutional variables influence wage inequality. Of particular interest to political scientists is the finding that the wage-distributive effects of government partisanship are contingent on institutional context. Union density emerges in the analysis as the single most important factor influencing wage inequality in both institutional contexts.

Reassessing the Three Waves of Democratization

By RENSKE DOORENSPLEET

Since the publication of Samuel Huntington's 1991 study of democratization, scholars have come to take for granted the notion that the spread of democracy has come in waves. Although Huntington's work has clearly proved to be an influential study, this article suggests that his analysis is far from compelling. There are two problems embodied in the work. The first is largely conceptual. Huntington's analysis fails to provide a clear and meaningful distinction between democratic and authoritarian regimes because it focuses primarily on what Dahl had defined in 1971 as the dimension of competition and pays insufficient attention to the equally important dimension of inclusion. The second problem is more empirical. Huntington has estimated the incidence of transitions to democracy in terms of the *percentages* of world states involved. Since the denominator in this equation, that is, the number of states in the world, is far from constant, this measure can be misleading. This article proposes solutions to both of these problems, and this new approach leads to conclusions that are quite different from Huntington's.

The new findings are important not only because they suggest a somewhat altered sequencing and a more accurate count of democratization waves but also because they cast real doubt on the appropriateness of the wave metaphor. As the reverse waves are not really apparent from these data, these results therefore also indicate that future studies should be cautious in comparing, explaining, and forecasting different "waves" of democratization.

The Study of Money

By JONATHAN KIRSHNER

Monetary phenomena define the contours of the contemporary global economy. This is a recent development, and it will transform the study of international political economy (IPE). Two excellent new books, *The Geography of Money*, by Benjamin Cohen, and *Mad Money*, by Susan Strange, will frame, support, and provide the point of departure for scholars addressing this vital question. Ultimately, however, and perhaps necessarily, these books raise more questions than they answer. But they do suggest in which direction the most promising avenues of investigation point—toward the study of the unique interconnections between the ideas, material interests, and institutions associated with the management of money. Those relationships are profoundly consequential for politics and demand the renewed attention of contemporary scholars of international relations and political economy.

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IDENTITY AND PERSUASION
How Nations Remember Their Pasts and Make Their Futures

By CONSUELO CRUZ*

IDENTITY politics now occupies center stage. It is on explosive display in a wide range of settings, from Africa to the Balkans. And it is more subtly at work in the democracies of the West: NATO leaders must reexamine their own guiding principles in the face of multiple humanitarian disasters brought about by tribal, ethnic, and religious hatreds, while simultaneously dealing with increasingly heterogenous populations at home and ceaseless migrant flows from east and south.

It is no surprise, then, that identity should figure prominently in scholarly debates about conflict resolution, migration, citizenship, transnational alliances, democratization, nation and state building, and even globalization. Nor is it a puzzle that long-standing debates about identity should have produced the two clearly defined camps that we know as primordialists and constructivists.[1] What is perplexing is the current failure to investigate systematically the complex linkages between identity formation and the expressive practices of political actors. After all, we approach reality rhetorically—that is, with an intent to convince.[2] This is why persuasion is the hallmark of effective leadership. Short of pure coercion, it is the most direct way to mobilize or paralyze a group. And this is why rhetorical power—recognized as cen-

* I would like to thank Peter Hall, Jeffrey Legro, Sheri Berman, and Mehmet Tabak for their insightful suggestions on a previous version of this article. I am also grateful to Deborah Yashar, Anna Seleny, Paola Cesarini, and the anonymous reviewers for their helpful comments on the present version. Any errors that remain are my responsibility alone.

[1] A third approach, instrumentalism, concentrates less on identity formation and more on the rational incentives that motivate political entrepreneurs to mobilize their "primordial" constituencies. In this article the role of political leaders is also emphasized (although I explore the popular dimension of identity formation elsewhere, in Cruz, "World Making in the Tropics: The Politics of Fate and Possibility" [Book manuscript]). But leaders' mobilizational motivations and capabilities, as well as rationality itself, are treated here as embedded in the broader political-cultural conditions shared by their respective groups. A more detailed discussion on this point follows in the text below, with reference to David Laitin's work.

[2] J. Gusfield, *Kenneth Burke: On Symbol and Reality* (Chicago: University of Chicago Press, 1989), 13, 29.

World Politics 52 (April 2000), 275–312

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tral to the workings of the polity since classical antiquity—is deployed by the full range of political agents, from aboriginal chiefs in recondite regions of South America to professional politicians on Capitol Hill.[3]

This article makes two arguments. The first is that we cannot grasp the nature and dynamics of political identity—and collective identity more broadly—unless we understand the rhetorical frames that emerge as dominant at critical junctures in the history of a group or a nation. Indeed, we will see that it is precisely because identity, memory formation, and rhetorical frames are so closely entwined that identity has both the appearance of naturalness emphasized by primordialists and the constructed properties emphasized by constructivists. The logic here is as follows. Collective memory, by its very nature, impels actors to define themselves intersubjectively. Shaped by past struggles and shared historical accidents, collective memory is both a common discriminating experience (this was right, that was wrong) and a "factual" recollection—a seemingly veridical narrative—of the group's past "as it really was."[4] Thus whether in war or in peace, a collectivity expresses and defends its identity by declaring, "We are as we are because the world has made us this way; and because we are who we are, we can change our world only so much without changing ourselves."

This declarative imperative does not suggest, however, that identity is reducible to a rhetorical manifesto. Rather, it simply suggests that while the impetus for identity formation arises from collective memory and contextual changes, identity is ultimately contingent on a "realistic" description of the world and on a relatively strict understanding of the permissible and the forbidden. And on neither of these counts can collective self-definition be completed without the active participation of those living the identity. At critical points, for example, rival political leaders and entrepreneurs seek to persuade themselves and others that things must either remain as they are or be changed in significant ways. In their efforts at persuasion, rivals must appeal to the national group's sense of practical competence (its sense of mastery over the

[3] For a superb exploration of the role of eloquence in tribal politics, see Pierre Clastres, *Society against the State* (New York: Zone Books, 1989).

[4] This view of collective memory hinges on the narrative construction of history while at the same time eschewing the presumed split between the normative and cognitive thrusts behind narrative construction. For some, like Hayden White, the objective behind the construction of sequenced history is to impose a normative claim to authority. For others, like Louis O. Mink, narrative construction is a cognitive enterprise. See White, *Metahistory* (Baltimore: Johns Hopkins University Press, 1973); idem, "The Value of Narrativity in the Representation of Reality," in W. J. T. Mitchell, ed., *On Narrative* (Chicago: University of Chicago Press, 1981); and Mink, "Everyman His or Her Own Annalist," in Mitchell. For a succinct discussion of the split, see David Carr, *Time, Narrative and History* (Bloomington: Indiana University Press, 1986).

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world) and to its convictions about the possible (what the group can or cannot do; and normatively, what it must or must not do). In brief, rivals seek a political grip on the constitutive elements of collective identity.[5] This they cannot do at will, however. They must advance their competing visions and agendas within a dominant rhetorical frame—a discursive structure that articulates in accessible ways the fundamental notions a group holds intersubjectively about itself in the world and that allows or disallows specific strategies of persuasion on the basis of their presumptive realism and normative sway.

The second argument this article makes is that the (trans)formation of collective identity shapes a nation's political and economic development.[6] The logic of this second argument is closely related to that of the first. Because actors situate their struggles within a dominant rhetorical frame, political contests between them engender a *collective field of imaginable possibilities*, which I define as a restricted array of plausible scenarios of how the world can or cannot be changed and how the future ought to look. This field's boundaries are established at critical points, along with new sets of power relations and the rhetorical settlements that accompany their construction. Within such boundaries, actors routinely make claims to vocality, manipulate the positive and negative values assigned to past defining experiences, generalize from these claims and experiences to craft "simply is" statements about reality, and drawing on this generalization, identify viable routes—be they conservative or transformative—to a better future.

But since a collective field of imaginable possibilities is both a system of meanings (attached to vocality, past experiences, reality, and the future) *and* an arena for the play of rhetorical practices, it is also internally vulnerable to endogenous shifts. Indeed, actors' rhetorical struggles can introduce disorientation into the field and, by extension, challenge the dominance of a particular rhetorical frame.[7] Here the microdynamic is simple. Competing political leaders and entrepreneurs

[5] This claim is congruent with the notion that national-identity formation is inseparable from the interplay of actors' other political identities and agendas. See Prasenjit Duara, "Historicizing National Identity, or Who Imagines What and When," in Geoff Eley and Ronald Grigor Suny, eds., *Becoming National* (New York: Oxford University Press, 1996).

[6] Development is not conceived here as a fixed end point. Rather, development is the ongoing, effective creation of institutional conditions that (1) a critical mass of agents deems necessary for the rational pursuit of economic prosperity and that (2) allow for the establishment of a viable system of political legitimation, thus making possible the relatively smooth distribution of material resources and the stable allocation of authoritative functions and prerogatives among rulers, officials, and citizens.

[7] Even in the natural sciences, individuals live with doubt, to which they respond in a variety of ways, ranging from isolated tinkering to heated debate and paradigmatic discovery. Thomas S. Kuhn, *The Structure of Scientific Revolutions* (Chicago: University of Chicago Press, 1970).

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intuit Edmund Burke's dictum that "it is one thing to make an idea clear and another to make it affecting to the imagination."[8] And so they seek at least one of two goals. Political leaders and entrepreneurs aim to (re)cast a particular agenda as most appropriate to a given collective reality or to recast reality itself by establishing a (new) credible balance between the known and the unknown. In the former instance they aim to establish the facts and weave them into a whole that is likely to be accepted as both "realistic" and "just." In the latter, they aim to reshape the collectivity's intersubjective "realism" and its sense of viable justice—in short, to redefine the limits of the possible, both descriptively and prescriptively. At such moments collective identity itself is open to revision, actors' choices and power relations may be reconfigured, and leaders may either gain or lose the ability to craft and execute developmental programs.[9]

The empirical evidence offered for this argument is a comparative study of the role of collective identity in molding the postcolonial development of two contrasting cases: Costa Rica and Nicaragua. The comparative starting point is the formation of colonial power relations, collective memories, and rhetorical legacies. Once these are established, the analytical focus shifts to the two distinct types of strategic rhetorical practices that rose to prominence in the two countries in the wake of independence. We might call one type the "Alchemist's Trick"; this was the Costa Ricans' way. Another was the Nicaraguan option; call it the "Fatalist's License." Through the former, rivals minimized the threat they posed to each other by emphasizing their shared virtues. Through the latter, they sought justification for bending the rules to selfish advantage by stressing their common flaws.

The more postcolonial leaders deployed these strategies, the more they entrenched (often unwittingly) two contrasting but equally powerful rhetorical frames. The Costa Ricans' frame upheld as truth the claim that they were, both by reputation and in fact, an inherently peaceable and diligent people. This frame, in turn, restricted the intensity and scope of political debate and struggle, creating in the process sufficient space for intraelite consensus building and, ultimately, the political stability necessary to craft and execute developmental policies. In the case of postcolonial Nicaragua, the argument is exactly the reverse.

[8] Cited in Virginia Sapiro, *A Vindication of Political Virtue* (Chicago: University of Chicago Press, 1992), 190–91.

[9] Thus the dichotomy between culture as a system of meaning and culture as practice dissolves in a collective field of imaginable possibilities. For an excellent critique of this dichotomization, see William H. Sewell, Jr., "The Concept(s) of Culture," in Victoria Bonnell and Lynn Hunt, eds., *Beyond the Cultural Turn* (Berkeley: University of California Press, 1999), 46–47.

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The rhetorical frame that triumphed there generated a set of negative expectations that created incentives among political rivals for *preemptive, particularist* bids, thus closing off space for effective developmental leadership. The upshot of all this was the emergence of distinct national identities and equally distinct collective fields of imaginable possibilities—one as "civic" and optimistic as the other was "anarchic" and fatalistic.

I. Positioning the Argument

Primordialists take identity as fixed by inherited linguistic, racial, ethnic, and/or territorial commonalities. For constructivists, however, identity is tied not to a marker but to the civic and political commonalities that bind a national group together. But not even these commonalities are fixed, since national tradition itself is a political invention. Moreover, for constructivists, identity can be contingent on choices that individuals make within shifting sociopolitical and historical environments, especially in response to the bids of entrepreneurs who trade in the business of identity politics.[10]

The view of identity advocated above—call it an argument for *declarative identity*—differs sharply from primordialist definitions. Primordial markers matter in cases where linguistic, religious, and racial groups are in conflict or where exclusivist claims to a particular territory are at play.[11] But such markers are less useful in getting at the core of collective identity in relatively homogenous settings where they are not used by the actors themselves or where these markers have been either marginalized in the public arena or subsumed under a broader worldview. Constructivist accounts, by contrast, tend to be flawed in one of two ways. In the civic and political variant, identity is often treated as a functional extension of modernization and nation building.[12] The invention-of-tradition variant, in turn, risks voluntarism by stressing the will and capacity of nation builders in the invention and sacralization of collective identity.[13]

[10] Clifford Geertz, *The Interpretation of Cultures* (New York: Basic Books, 1973).

[11] For an example of the argument that ethnicity is the core determinant of national identity, see Walker Connor, *Ethnonationalism: The Quest for Understanding* (Princeton: Princeton University Press, 1994). And for the claim that the ethnic factor is always present to some degree in the making of national identity, see Anthony Smith, *National Identity* (London: Penguin Books, 1991).

[12] Ernest Gellner, for one, treats national identity as necessary to modernization and nation building. See Gellner, *Nations and Nationalism* (Oxford: Basil Blackwell, 1983).

[13] See Eric Hobsbawm and Terence Ranger, eds., *The Invention of Tradition* (Cambridge: Cambridge University Press, 1983).

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My argument for declarative identity builds selectively on constructivist scholarship by stressing the intersubjective, constructed properties of identity, but it tries to avoid functionalism and voluntarism in several ways. First, I start from the premise that invention is a constrained activity. Consider here the credibility dilemma we all confront at one point or another. On the one hand, we cannot always remember everything. On the other, when faced with a momentous choice, we need to feel as if we do remember it all, and so we invent what we cannot remember. Yet a historical invention must be *credible;* it must ring true. Political leaders and entrepreneurs understand this well. They also know that the ring of truth is often no more than the ring of the familiar. Thus at critical moments political rivals will draw on the same rhetorical frame—the same fundamental, easily graspable "truths"—to advance their contending views of past and future. Indeed, this tendency to turn to easily graspable truths is partly why, as Radman reminds us, "invention is little more than a new combination of those images which have been previously gathered and deposited in the memory."[14] (In the late eighteenth century, for example, North American colonials were able to articulate simultaneously their allegiance to Great Britain and their differences with the British monarchy by drawing on images embedded in English legal and political tradition).[15]

The argument for declarative identity, moreover, admits that while political invention is a constrained activity, invention may also happen inadvertently. The underlying claim here is that rhetorical politics can destabilize actors' purposeful aims. Contending arguments, for example, need not remain a linear projection of shared premises, since they interact in unpredictable ways with the behaviors and events they promote. In addition, the changing demands of competition prompt rivals to make rhetorical refinements, elaborations, and connections that in turn may cause shifts in the collective field of imaginable possibilities. (North American colonial elites also rendered the radical idea of independence both plausible and justifiable, in part because their own debates led to the creative deployment of the very same tradition of English law and political theory that had once tied them to Great Britain.)

Finally, my argument for declarative identity assumes that cultural entrepreneurs and their potential clients are embedded in the same col-

[14] Zdravko Radman, *Metaphors: Figures of the Mind* (The Netherlands: Kulwer Academic Publishers, 1997), 63–65.

[15] Tadahisa Kuroda and Erwin Levine, "The United States: Creating the Republic," in Mary Ellen Fischer, ed., *Establishing Democracies* (Boulder, Colo.: Westview Press, 1996).

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lective field of imaginable possibilities. As in Ann Swidler's "tool kit" approach to culture, all actors draw on the same "repertoire" of symbols, stories, and worldviews to craft and execute their strategies. If actors persist in their political-cultural practices, it is not because they are "cultural dopes." If they quit, it is not because they are without culture. Rather, actors in each case behave as competent "users of culture."[16] This key assumption helps us get at both the naturalness and the plasticity of identity without falling prey to the problems that plague instrumentalist approaches, like the tipping model of identity formation.

In David Laitin's rendition of the tipping model, for example, cultural entrepreneurs are treated as if they are invulnerable to the equilibrium conditions under which other members of a linguistic, racial, ethnic, and/or national group experience their beliefs and practices as natural. Cultural and political elites, that is, "give meaning to the equilibrium" by providing the group with a set of "beliefs, principles, and constraints," but elites themselves appear unencumbered by "meaning" as they respond strategically to changing incentives.[17] Meanwhile, the agency of followers and clients is split as follows. On the one hand, they are sovereign decision makers when facing a dilemma. For example, when members of a peripheral culture must choose between their mother tongue and a newly legislated *national* language,[18] they weigh the costs and benefits of "switching" according to instrumental criteria, disregarding the judgment others might make about their choices. On the other hand, from the perspective of the tipping logic what matters most to a decision maker is what others are doing because this is how individuals evaluate future costs and benefits, which is why a cascade can occur at all. The upshot of all this is that the importance of meaning—and identity's presumed naturalness—are lost in the thick of actors' instrumentalism.

Swidler's approach does not split actors in these ways, but it does presume *two* models of cultural causality: one that obtains during "settled" periods and another that obtains during "unsettled" times. In settled times culture influences behavior because it provides the resources with which agents put together lines of action. In unsettled periods "explicit ideologies" rule over action, but structural opportunities for action determine the fate of competing ideologies.[19] This duality, however,

[16] Ann Swidler, "Culture in Action: Symbols and Strategies," *American Sociological Review* 51 (April 1986), 273–86.

[17] David Laitin, *Identity in Formation: The Russian-Speaking Populations in the Near Abroad* (Ithaca, N.Y.: Cornell University Press, 1998), 22.

[18] Ibid., 25–27.

[19] Swidler (fn. 16).

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begs the question of transition from settled to unsettled times and its causes. In contrast, my argument for declarative identity—with its emphasis on rhetorical frames and fields of imaginable possibilities—allows for endogenous transitions. Contestation is present when political actors construct rhetorical frames in an attempt to organize action and (re)organize reality. But contestation is also present once a particular frame has been imposed, precisely because that same frame generates internal interpretative conflicts, which may eventually lead to critical historical junctures. At such points, a dominant frame becomes one among competing frames, and its fate becomes indeterminate. This is partly why times become unsettled in the first place and shifts occur in a collective field of imaginable possibilities.

This argument for declarative identity, of course, raises its own set of questions. For instance: what is the discursively explicit, what is the practically known but unstated, and what is simply embedded in the unconscious? My argument, however, is concerned exclusively with the discursively explicit, a restriction grounded in three related considerations. First, it is extremely difficult to access actors' interior worlds. Take, for instance, ideology. As Joseph Schull argues, even individuals who belong to the same ideological group can hold divergent interpretations of the relevant ideological claims. This divergence is possible—perhaps even unavoidable—because an ideology ultimately resides in people's minds.[20] Yes, ideological treatises and platforms exist in objective form. But their content is processed and transformed internally, and for this reason, therefore, the authenticity of political agents' ideological pronouncements can be called into question, both by other actors and by observers. (Even if an individual sacrifices himself on a pyre in a sincere effort to make an ideological point, rivals can always claim that self-immolation was really motivated by vainglory or, more pathetically, by an inadequate understanding of the cherished ideology.)

Second, because of the ever-present possibility of a discrepancy between ideological tenets and people's internal interpretations, it is analytically prudent to concentrate on actors' discursive productions and manipulations. James Scott, for one, argues that in power relations between oppressors and subordinates, the latter can and do feign ideological conviction—put on masks—and keep false faith with a dominant ideology.[21] Conversely, as Timur Kuran points out, subordinates may well

[20] Schull, "What Is Ideology? Theoretical Problems and Lessons from Soviet-Type Societies," *Political Studies* 40 (December 1992), 731.

[21] Scott, *Domination and the Arts of Resistance: Hidden Transcripts* (New Haven: Yale University Press, 1990), 110.

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loathe an oppressor and still fail to develop "cognitive autonomy"—fail to craft an alternative ideology—"precisely because of the social conditions created by the oppressor."[22]

Actors' enduring manipulative capability and the alternative possibility that oppression saps their ideological imagination are both plausible claims. Yet neither can be asserted in a particular case without empirical investigation. In both cases the advantage of concentrating on rhetorical frames and fields of imaginable possibilities is clear. Because discourse is an intersubjective event, as Schull argues, discourse and its individual agents are relatively autonomous from each other. Discourse is relatively autonomous since its viability does not require the faith of its agents; instead, discourse requires agents "to respect certain conventions for meaningful communication." Agents, in turn, are relatively autonomous because they need not demonstrate ideological exactitude and depth to be taken seriously; instead they must demonstrate a significant degree of consistency between their respect for discursive conventions and their own actions.[23] And since discursive conventions and actors' actual respect for those conventions (as indicated by their behavior) are both *observable* phenomena, one does not need to know agents' internal processes in order to arrive at plausible findings.[24]

Third, and finally, I focus exclusively on rhetorical politics because the observable properties of discourse are even more pronounced in rhetorical productions. Rhetorical strategies, for example, are deliberately and closely aimed at persuasion and so they generate recognizable patterns of argumentation. In fact, the more distinct a particular pattern—that is, the more different it is from rival arguments and the more identifiable it is with particular actors—the greater its potential effectiveness. But also the more exposed its vulnerable points become, and therefore the greater the ability of contending actors to organize and focus their attacks.[25] This competitive dynamic can lead either to entrenchment of a dominant rhetorical frame or to varying degrees of

[22] Kuran, *Private Truths, Public Lies: The Social Consequences of Preference Falsification* (Cambridge: Harvard University Press, 1995), 175.

[23] Schull (fn. 20), 732.

[24] Ibid., 731.

[25] Albert O. Hirschman, for instance, has shown that the rhetorical struggles associated with landmark social and economic reforms in the advanced industrial democracies produced "contrasting pairs" of arguments that not only shaped the struggles themselves but, whether progressive or reactionary, could be "exposed" as "extreme statements" in "highly polarized debates." Once exposed, such statements may be reduced to the status of "limiting cases" in need of qualification, mitigation, and/or amendment. See Hirschman, *The Rhetoric of Reaction: Perversity, Futility, Jeopardy* (Cambridge: Belknap Press of Harvard University Press, 1991), 166–67.

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disarray within the collective field of imaginable possibilities—and perhaps to the emergence of a new dominant frame. Regardless of the outcome, however, the relevant meanings, practices, and structures remain analytically discernible.

II. The Case for the Cases and Contending Accounts

By the dawn of the nineteenth century, according to Benedict Anderson, Spanish American "creole communities" had developed a sense of "nation-ness"—they had begun to imagine the "fraternal" bonds that would soon hold together their individual republics, from the smallest to the largest. But as I have argued elsewhere, a close reading of actors' discursive positions and political strategies shows that creole elites relied on familial metaphors in a desperate effort to contain the "anarchy" of internal fragmentation that haunted their societies on the eve of independence and even more acutely in its aftermath.[26] Nicaragua was an extreme example of anarchic implosion, whereas neighboring Costa Rica was relatively tranquil. Moreover, while postcolonial Costa Rica soon proved a political-economic developmental success, Nicaragua was a study in failure.[27] Their contrasting fortunes make the two countries excellent cases for comparative analysis of nation and state building in postcolonial Spanish America.

Comparison of the two countries can also be enlightening on a number of additional counts. First, postcolonial societies often share one key characteristic with severely fragmented societies elsewhere: political actors typically operate under conditions of impending disarray and entrenched mistrust. Second, postcolonial societies, like today's transition societies, are in close contact with the history of a prior regime—both because collective memory is still fresh and because institutional-political legacies are still vibrant. But since those memories and legacies are substantively different from those of, say, postcommunist societies, analysis of postcolonial cases can enhance our comparative perspective and thus increase our capacity to draw conclusions about epochal transitions at an even higher level of generality. Third, and finally, postcolonial actors' success or failure in taking effective control of the polity and economy depends on their ability to regulate mistrust and institutionalize legitimate systems of arbitration and distribution.

[26] See Benedict Anderson, *Imagined Communities: Reflections on the Origin and Spread of Nationalism* (New York: Verso, 1991), 7, 50, 60. I develop my counterclaim in Cruz (fn. 1).

[27] Developmental success or failure is assessed according to the criteria outlined in fn. 6.

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Thus postcolonial cases can illuminate political entrepreneurs' use of collective memories and legacies for good or for ill.

Recent transitional processes, of course, were partially shaped by demonstration effects conveyed at rapid speeds unimaginable in colonial times. We need only recall the diffusion of information from Poland to Hungary to East Germany in the late 1980s. Nevertheless, the geographical proximity of Costa Rica and Nicaragua, plus their close administrative ties under the late colonial regime, make them excellent cases for a comparative study with broader implications. Even in the last decades of the eighteenth century and the early decades of the nineteenth, administrative ties (and jealousies) prompted Costa Ricans and Nicaraguans to assume a stance of mutual observation. Moreover, while news from Guatemala might not reach either Nicaragua or Costa Rica for weeks, it took only days for Nicaraguans and Costa Ricans to become aware of their respective developments.[28] Costa Rica and Nicaragua were directly exposed to each other's demonstration effects and typically entered into an intimate communicative sphere both before and after becoming exposed to broader currents. The fact that they nevertheless proved resistant in the end to one another's influence is itself part of the puzzle to be solved. (By contrast, the transmission of information between the capitals of the Southern Cone or between Mexico City and the other major power centers in Spanish America was excruciatingly slow.)

Comparing Costa Rica and Nicaragua is also particularly helpful because scholars in both countries have shown a marked tendency to generate mirror-image national-character explanations.[29] Mainstream

[28] Guatemala was the administrative seat of the Kingdom of Guatemala, which comprised all of colonial Central America. Following independence in 1821 and the collapse of the ephemeral Mexican empire in 1823, the various Central American states formed a federal republic, which by 1838 was virtually defunct.

[29] These explanations, it should be noted, bear scant analytical relation to sophisticated national-character arguments. Alex Inkeles, for example, posits that national character refers to "the mode or modes of distribution of personality variants within a given society." The national-character explanations articulated by Costa Rican and Nicaraguan scholars, in contrast, merely echo and reinforce dominant mythologies that are part and parcel of intersubjective realisms established through long-forgotten contestations. And yet, analytically unrelated as they are, both Inkeles's argument and the homegrown national-character explanations eclipse intersubjective dynamics and contestation processes. Inkeles treats national character as the *collective* expression of *individuals'* personality, and he assumes an interrelation among modal personality, institutional structures, cultural patterns, and the actions of nation-states. By taking a cumulative rather than an intersubjective perspective, Inkeles forecloses the possibility of a group dynamic independent of its members' personality makeup. By removing the element of struggle, he reduces individuals and macrostructures to unproblematic reflections of one another. But while Inkeles's reductionism helps explain the declining influence of national-character explanations, the simplifications by Costa Rican and Nicaraguan scholars hint at some of the ways in which different rhetorical frames became entrenched in our two cases. Inkeles, *National Character: A Psycho-Social Perspective* (New Brunswick, N.J.: Transaction Publishers, 1997).

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Costa Rican historiography tends to accept prima facie the "conciliatory" nature of Costa Rica's conquest[30] and to view postcolonial elites as carriers of the traits and habits first exhibited by the country's exceptionally "peaceful" conquerors.[31] Conversely, Nicaraguan historiography tends to accept uncritically the specially brutal character of the country's conquest.[32] Once vested with the authority of history, these mythologies help set the parameters for new rhetorical struggles.

Yet another reason for comparing Costa Rica and Nicaragua along the vectors of collective identity and rhetorical politics is that even when these countries' own scholars cast aside national-character explanations in favor of socioeconomic or ideology-based explanations for the countries' developmental trajectories, they still reinforce the countries' mythological legacies and render the countries' histories as chronicles of foretold success and failure. Explanations that stress divergent socioeconomic conditions at the start of the postcolonial period, for example, often share a logic that runs as follows. The Spanish metropole consistently overlooked the province of Costa Rica because it was poor in Indians. This neglect led to the politico-administrative marginalization of the province and to a widening poverty. And both these conditions in turn accustomed Costa Rica's colonial elites—and their postcolonial successors—to de facto politico-administrative autonomy and to the more egalitarian relations associated with labor-scarce colonies.[33] Conversely, Nicaragua with its large Indian population, grew accustomed to the exploitative relations that characterized better endowed colonies.[34]

But in fact, the countries' endowments of indigenous labor were not radically unequal. By the mid-sixteenth century Nicaragua's conquerors

[30] Eugenio Rodríguez Vega, *Biografía de Costa Rica* (Biography of Costa Rica) (San José: Editorial Costa Rica, 1981), 19; Carlos Meléndez, "Los Poderes Conferidos al Alcalde Mayor Licenciado Juan de Cavallón," in *IV Centenario de la Entrada de Cavallón a Costa Rica, 1561–1961* (IV Centennial of Cavallón's incursion into Costa Rica, 1561–1961) (San José: Imprenta Nacional, 1961), 41; and Jorge Lines, "Integración de la Provincia de Costa Rica bajo el Reinado de Carlos V," in *IV Centenario*, 21, 25–31.

[31] Hernán Peralta, *Don José María Peralta* (San José: Editorial Hermanos Trejos, 1956), 21. See also Juan Rafael Quesada, "Educación y Democracia en Costa Rica," in Jorge Mario Salazar, *Democracia y Cultura Política en Costa Rica* (Democracy and political culture in Costa Rica) (San José: Ministerio de Cultura, Universidad de Costa Rica, 1990).

[32] See, for example, Gustavo Alemán Bolaños, *El País de los Irredentos* (A country of irredeemables) (Guatemala City: Tipografía Sánchez y de Guise, 1927); José Coronel Urtecho, *Reflexiones sobre la historia de Nicaragua*, vol. 1 (Reflections on the history of Nicaragua) (León: Editorial, 1962); and Ernesto Cardenal, *El Estrecho Dudoso* (The doubtful strait) (Mexico City and Buenos Aires: Ediciones Carlos Lohlé, 1972).

[33] The most important exponent of this view is Carlos Monge Alfaro, *Historia de Costa Rica* (San José: Hermanos Trejos, 1980).

[34] Edelberto Torres Rivas, *History and Society in Central America* (Austin: University of Texas Press, 1993).

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had virtually devastated the indigenous population; and by the early decades of the nineteenth century the abundance of land merely reinforced the labor shortage. Moreover, postcolonial Costa Rica's initial distributional structure was neither remarkably egalitarian nor extraordinarily polarized; that is, it was not substantially different from the structure that obtained spontaneously in land-abundant Nicaragua. Costa Rica's labor scarcity certainly did not translate ipso facto into an egalitarian society.[35] As William Roseberry shows: "Smallholders produced and sold their coffee—and secured labor for their coffee plots—within hierarchical social fields." Hence his caution against the "temptation" to treat "smallholder regimes" as the foundation for "rural democracy."[36]

Analyses that focus on socioeconomic interests as determinants of postcolonial ideologies are similarly flawed.[37] Costa Rican exceptionalism, for example, has been explained as the felicitous outcome of an ideological struggle between the "republican" disposition of an aborning bourgeoisie and the "retrograde" impulses of the colonial aristocracy.[38] In contrast, ideological backwardness in postcolonial Nicaragua—characterized by weak or nonexistent modern ideologies—has been treated as the superficial expression of socioeconomic undifferentiation.[39] But this ideological variant of the socioeconomistic account is contradicted by scholarship demonstrating that Costa Rican elites, like all the other regional elites, "lacked clear socio-economic or ideological lines of party affiliation."[40]

[35] Carlos Meléndez, "Bosquejo para una historia social costarricense antes de la independencia," in Carmen Lila Gómez et al., eds., *Las Instituciones Costarricenses del Siglo XIX* (Costa Rican institutions in the nineteenth century) (San José: Editorial Costa Rica, 1985), 35–48.

[36] Hierarchical distinction, while not peculiar to Costa Rica, does go against its yeoman-democracy image, especially once we take into account the fact that postcolonial elites' command of credit resources and of "administrative skills and commercial contacts" led to skewed control of coffee processing and export marketing. William Roseberry et al., eds., *Coffee, Society, and Power in Latin America* (Baltimore: Johns Hopkins University Press, 1995), 20; Samuel Stone, *La Dinastía de los Conquistadores: La Crisis del Poder en la Costa Rica Contemporánea* (The conquerors' dynasty: A crisis of power in contemporary Costa Rica) (San José: EDUCA, 1975), 75–76; and Lowell Gudmundson and Héctor Lindo-Fuentes, *Central America, 1821–1871: Liberalism before Liberal Reform* (Tuscaloosa: University of Alabama Press, 1995), 46–47.

[37] For a prominent exponent, see Rodolfo Cerda Cruz, *Formación del estado en Costa Rica* (State formation in Costa Rica) (San José: Editorial Universidad de Costa Rica, 1967), 96–99,156–59.

[38] This account also overlooks the fact that Costa Rica's aristocracy (located in the "closed" city of Cartago) *and* the progressive elites (located in "bourgeois" San José) were one and the same, both in terms of social origins and in terms of access to national power. See Stone (fn. 36) for the shared genealogy of power holders.

[39] Jaime Wheelock, *Imperialismo y dictadura: crisis de una formación social* (Imperialism and dictatorship: Crisis of social formation) (Mexico City: Siglo XXI, 1975).

[40] Lowell Gudmundson, *Costa Rica before Coffee: Society and Economy on the Eve of the Export Boom* (Baton Rouge: Louisiana State University Press, 1986), 4.

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Looking beyond the works of national scholars, we find several sophisticated accounts of Central American divergent developmental paths. Two stand out. One is Jeffery Paige's argument that these paths can be traced to the patterns of elite dominance that emerged in the export coffee economies of the nineteenth century and to how elites related to the rural masses. The Costa Rican pattern, Paige shows, can be properly understood only with close analytical reference to elite narratives and stories—most notably the "white legend" that shaped relations of production in a coffee economy in which aristocratic producers became symbiotically entwined with medium and small producers in the mid-nineteenth century.[41] Paige, however, does not theorize the broader theme of exceptionalism, nor does he link the legend's viability —either structurally or semiotically—to this theme or to the colonial antecedents of national-identity formation. A second outstanding account is provided by Deborah Yashar, who argues that democratic development is determined by institutional legacies, political coalitions, and the context of reforms.[42] These factors, undoubtedly crucial, are most revealing when placed in a full historical context—a task that calls for scrutiny of the formative political-cultural struggles that took place prior to the mid- and late nineteenth century (the starting point for Yashar's in-depth analysis of Guatemalan and Costa Rican development). For as I demonstrate below, the political-cultural legacies of the colonial period and the political-cultural adaptations of the postcolonial years decisively shaped the developmental trajectories of Nicaragua and Costa Rica throughout the remainder of the century.

This article therefore offers an explanation for identity formation and power contestation under the colonial regime; it also spells out the impact of collective memory and rhetorical practices on national identities and the formation of political and economic structures in the postcolonial era (1821–50). Standard approaches to Latin American political history tend to overlook these dynamics, however.[43] This is a

[41] Paige, *Coffee and Power: Revolution and the Rise of Democracy in Central America* (Cambridge: Harvard University Press, 1997), 47.

[42] Yashar, *Demanding Democracy: Reform and Reaction in Costa Rica and Guatemala, 1870s–1950s* (Stanford, Calif.: Stanford University Press, 1997).

[43] Ralph Lee Woodward, for example, astutely concentrates on familial and localist struggles but does not connect them to actors' rhetorical strategies. See Woodward, "The Aftermath of Independence, 1821–1870," in Leslie Bethell, ed., *Central America since Independence* (New York: Cambridge University Press, 1991). Similarly, Victor Bulmer-Thomas treats the emergence of national identity in Latin America as dependent on the success or failure of economic development. Bulmer-Thomas is certainly correct that the two are related. But as I argue below, the causality runs in the other direction: national identity shapes developmental outcomes. See his excellent work, Bulmer-Thomas, *Economic History of Latin America since Independence* (New York: Cambridge University Press, 1994), 19–45.

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serious blind spot. Postcolonial Costa Rican political leaders, for example, increasingly relied on the notion that their colonial experience had bequeathed to them a tradition of civility that defined their mandate for the future—to protect their unique way of life from *external* disruption. Nicaraguans, by contrast, came to believe that they were threatened from *within* by evil and anarchy. Both beliefs derived from critical rhetorical battles and settlements that shaped group memories and local power relations under the colonial regime (Sections III and IV below). Yet these beliefs did not develop ipso facto into coherent national identities. For this to happen, the legacies of the past and the political agency of those living in the moment had to come together. Legacies and agency were joined in the rhetorical strategies of competitive postcolonial elites (Section V). These strategies—and the rhetorical frames they entrenched—can be summarized as the Alchemists' Trick and the Fatalists' License mentioned earlier. But to understand these frames, we must first grapple with the rhetorical struggles, the power relations, and even the historical accidents that went into the creation of collective memory during the long colonial epoch. It is to this task that I now turn.

III. The Rhetoric and Politics of Conquest

If ever there was a society of political entrepreneurs, it was colonial Spanish America. Denied the right to elect representatives to the *córtes* in Spain, colonials were granted the privilege of corresponding directly with the royal sovereign. In fact, the crown charged its overseas subjects with the task of keeping the metropole "properly informed."[44] King Ferdinand decided early on that he would not tolerate a governor's interference with the mail because "all who want to write to us should be free to do so, and any information received we will inquire about and we shall make our decisions on the basis of the whole truth; and truth once known we shall decide."[45]

Not surprisingly, letters to the king proliferated, and from the start conquerors exhibited a "story-making predilection."[46] The story at the core of these letters, however, was nothing less than a rhetorical strat-

[44] J. Crow, *The Epic of Latin America* (Berkeley: University of California Press, 1992), 167.

[45] Ursula Lamb, "Cristobal de Tapia v. Nicolás de Ovando, Residencia Fragment of 1509," *Hispanic American Historical Review* 33 (August 1953).

[46] Inga Clendinnen, "'Fierce and Unnatural Cruelty': Cortés and the Conquest of Mexico," in Stephen Greenblatt, ed., *New World Encounters* (Berkeley: University of California Press, 1993), 15.

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egy—a blueprint for persuasion. Even as the details of the letters varied according to time, place, and protagonists, the central strategy was the same. Adhering to the rhetorical frame of the conquest—a Manichaean frame that pitted virtue against vice—political entrepreneurs sought not only rewards for themselves and their allies but also punishment for their rivals. Conquerors, officials, and friars thus strove to convince the royal arbiter that while they were "dutiful" and "truthful," their rivals were "avaricious," "cruel," "disagreeable," "evil," "artful," and above all, "disloyal" to God and crown.[47]

Political entrepreneurship, rhetorical power, and identity formation also came together in the metropole. As a critical entrepreneur, for example, the friar Las Casas managed to persuade the sovereign that the *encomienda*—the system whereby the crown "commended" whole groups of Indians to "worthy" conquerors, who in exchange were awarded the tribute and labor of their charges—was so abused in the Indies that it eroded the legitimacy of imperial conquest and compromised the crown's moral authority. This was an argument that the crown, jealous of its exemplary identity, could not ignore. Through the New Laws of 1542, the crown launched a protracted but ultimately mortal attack on the *encomienda* system.[48]

Although conquerors everywhere were scandalized by the New Laws, their adaptive responses were varied.[49] In Nicaragua (as in Peru) they staged a rebellion. In most other colonies, however, rebellion was averted. The variation had much to do with the way rhetorical conflicts were settled. In Guatemala, for example, conquerors hammered home the point that the New Laws were the handiwork of clever friars and avaricious officials who used their formidable powers of persuasion to "dupe" the sovereign and his council.[50] These officials and friars, not the conquerors, were the real threat to the colonial universe and within that universe to the "Republic of Christians."[51] The Guatemalans' efforts paid off. A stack of royal decrees indicates that the crown responded

[47] Irwin Blacker and Harry Rosen, *The Golden Conquistadores* (Indianapolis: Bobbs-Merrill Company, 1960), 61–62.

[48] Ibid., 161.

[49] See Claudio Veliz, *The Centralist Tradition of Latin America* (Princeton: Princeton University Press, 1980), 29.

[50] James Lockhart and Enrique Otte, eds., *Letters and People of the Spanish Indies, Sixteenth Century* (NewYork: Cambridge University Press, 1989), 73–77.

[51] For cabildo letters, see Javier Ortiz de la Tabla et al., eds., *Cartas de Cabildos Hispanoamericanos, Audiencia de Guatemala* (Letters from Hispanic-American Cabildos, Audiencia of Guatemala) (Seville: Publicaciones de la Diputación Provincial de Sevilla; Publicaciones de la Escuela de Estudios Hispano-Americanos, 1984).

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quickly and forcefully when informed of anomalous conduct on the part of bureaucrats and religious orders.[52]

The Guatemalan conquerors, in fact, managed through these rhetorical battles to extract exemptions from the crown, diluting and postponing the local effects of the New Laws. In Nicaragua the outcome was radically different. As per the New Laws, the high court in Guatemala ruled that the governor of Nicaragua must give up his *encomienda.* He soon returned to Spain to press his case (1548). But the governor's troubles, significantly, were the result of a rhetorical campaign that the bishop of Nicaragua had been waging for some time against the official and his clan. In his first report to the king, in 1544, the bishop accused the governor and his clan of comporting themselves as if they were "lords of everything." The bishop's subsequent letters also expressed concern over the maltreatment of Indians. On the latter point the bishop reminded Charles V that one day he—the king—"would have to account to God." The bishop then joined forces with Las Casas: in a report to the Council of Indies, they argued that the "tyranny" and "violence" of Nicaragua's ruling clan imbued Indians with hatred and disdain for Christianity.[53]

These authoritative condemnations triggered a series of rhetorical countermoves. First, Nicaragua's *encomienda* holders argued (as all conquerors tended to do) that the laws violated their contract with the crown. Second, they insisted that the laws had been "inspired" by "wicked" friars. Third, they supported their particular grievances with reference to a general colonial view that held the king above reproach while imputing evil intentions to his officers (and even friars and ecclesiastical hierarchs). With the justification for rebellion finally in place, the governor's sons could take action while their father the governor was still in Spain: they stabbed the bishop to death in 1549.[54]

[52] For the original texts, consult Federico Arguello Solórzano and Carlos Molina Arguello, eds., *Monumenta Centroamericae Histórica: Colección de Documentos y Materiales Para el Estudio de la Historia y de la Vida de los Pueblos de la America Central* (Monumenta Centroamericae: Collection of materials and documents for the study of the history of the peoples of Central America) (Managua: Instituto Centroamericano de Historia, Universidad Centroamericana, 1965).

[53] Frances Kinloch Tijerino, "La cruz frente a la espada," in *Revista de Historia*, no. 5–6 (1995), 11–14.

[54] The absence of Nicaragua's governor from the province was a crucial historical accident, in the sense that with the governor away in Spain, his sons and their allies had no high representative of royal authority to turn to for on-site mediation. The only other high representative of the crown was the bishop—the very embodiment of evil in the rebels' eyes. Had the governor remained in Nicaragua, one of two alternative scenarios would likely have materialized. Either the governor himself would have led his clan in rebellion against the laws, in which case the outcome would have been even more similar to that of Peru. Or the governor and his clan would have refrained from rebellion and opted instead

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From the perspective of the crown the rebels had confirmed Las Casas' most disturbing argument against the *encomienda:* the colonial regime, controlled by tyrannical governors and abusive *encomienda* holders, was sliding into moral and political illegitimacy. The Nicaraguans' *open* repudiation of the New Laws, in fact, rendered the enterprise of conquest yet more vulnerable to the political, theological, and juridical attacks that were by then current in Europe.

In Spain itself the Indian question became a matter of bitter controversy, accentuating the split between those who believed hierarchy was the natural state of human society and those who saw equality as its inherent condition.[55] But the emergence of a new vision in the field of imaginable possibilities was at no point more palpable than during the famous polemic of 1550–51 between the humanist Sepúlveda and the friar Las Casas. On one side, the humanist argued that Indians and Spaniards were as different as "men and monkeys." Indians, in this view, were simply beyond redemption. On the other side was Las Casas, who argued that Indians, no less than Spaniards, were children of God, thus rejecting the notion of an insuperable moral gap between the races.[56] According to this alternative view, while the world was divided between morally "backward" and more "advanced" peoples, redemption was a *universal possibility.*

The crown ultimately assumed a synthetic position in this controversy by commissioning what was in effect the Americas' first official story. The state's senior cosmographer and chronicler was charged with the task of crafting a metanarrative of conquest, for the purpose of confirming "the justice and right of the Spanish crown's claim to dominion." Completing this task entailed a series of key rhetorical moves. The first move was to admit "the abuses" of the conquerors while emphasizing the crown's efforts "to protect its native subjects." The second move was to praise Las Casas' labor on behalf of Indians, so as to valorize the support given the good friar by the monarchy. The third move was to depict those same Indians as "great liars, drunkards, thieves, and in some cases, sodomites," so as to underscore the urgent need for the "good government" that only Catholic Spain could provide.[57]

in favor of de facto dilution of the laws, making the outcome similar to that of Guatemala. In these alternative scenarios, the logic of Manichaeanism would still have entered into play. But the bishop might not have been the target of the rebels' Manichaean outrage, and the "sacrilegious" dimension of identity-formation might have been precluded.

[55] Tzvetan Todorov, *The Conquest of America* (New York: Harper Perennial, 1982), 149–53.

[56] D. A. Brading, *The First America* (New York: Cambridge University Press, 1991), 82–100.

[57] Ibid., 209–10.

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IV. Memory and Power

The state's official story, finally published in 1601, was a rhetorical summation that in essence closed off the possibility for redemptive rhetorical campaigns on the part of Nicaraguan colonials. Memory formation and power relations were profoundly affected by this turn and so was the construction of the province's self-image. To begin with, the crown punished disobedient Nicaragua by eliminating its governorship and placing it under the direct rule of the Guatemalan authorities for over twenty years. This was crucial because the province's political subjugation, in combination with the devastation of the Indian population at the hands of the province's ruling clan, rendered the province unappealing to potential settlers. Spaniards came and went, disillusioned by the grim prospects for personal enrichment and political power. Consequently, Nicaragua was quite slow to develop a stable creole elite.

Second, the absence of such a stable elite meant that for a long time Nicaragua had no significant political actors with any durable interest in displacing or modifying the memories of anarchy and tyranny associated with the conquest of the province. Third, by the time Nicaragua was released from the tutelage of the authorities in Guatemala and a local elite slowly began to form, the crown had published its official story, bringing to an end the state's formal process of incorporating and excluding memories from recorded history.

The upshot of all this was that the Nicaraguan colonials of the seventeenth century had little incentive to engage in rhetorical campaigns. Thus, no record was made of postrebellion Nicaragua, no account given of its growing immersion in the normalcy of a poor and marginal colony. All that was left for posterity were the older accounts of Nicaragua's founding moment; all that was left were the horrors perpetrated by the province's conquerors against local Indians, the conquerors' sacrilegious murder of the bishop, and the province's fall from royal grace. Subsequent *uses* of this record by national scholars and intellectuals deepened the impression that regardless of the angle from which one examined the province's recorded past, the forces at play were the same: ambition, despotism, and violence, all combining and recombining to render Nicaraguans as tyrants, anarchists, or both.[58]

[58] The first "official" history of Nicaragua, written by a conservative in 1882, depicted Nicaragua's early conquerors as cruel and ambitious and the bishop whom they stabbed to death as a pious man. In 1889 an anticlerical liberal historian painted the bishop as a "victim of his own arrogance." But another liberal historian soon restored the initial interpretation, emphasizing the vileness of Nicaragua's conquerors while vindicating the bishop as a staunch protector of Indians. Tijerino (fn. 53), 5.

For illustrations of how the colonial historical record, taken prima facie, shapes the historiography

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This last interpretation not only prevailed but over time took on an aura of self-evident truth, in good measure because scholars and intellectuals failed to problematize its construction and deployed it for political-didactic purposes.

By contrast, the New Laws, so fundamental in shaping Nicaragua's ignoble image, had a fortuitous effect on Costa Rica's process of memory preservation and exclusion. Recall that the laws were issued in 1542, at which time Costa Rica's conquest was suspended between two seemingly discontinuous phases. The first phase peaked about 1539, when conquerors managed to penetrate Costa Rica's interior. That phase, however, soon came to a close because the savage persecution of Indians provoked an uprising, which in turn beat the conquerors into retreat. The second phase began only in 1561, almost two decades *after* the New Laws had been promulgated and upheld in the face of the Peruvian and Nicaraguan rebellions. So the conquerors arriving in Costa Rica would be forced to operate under changed conditions, which, though severely constraining at the time, allowed for better image making.

On one side the crown now saw clearly that conflict among conquerors and extreme violence against Indians were counterproductive. Accordingly, it instructed conquerors to "govern [themselves] in peace and tranquility" and to deal "peacefully" with the Indians, who were to be "attracted" to the faith.[59] On the other side were the conquerors of the second phase; acquainted as they were with the lesson learned from the cautionary tales of Nicaragua and Peru, they could expect to pay a heavy price for openly disregarding the New Laws.

Against this backdrop the province's founding governor, Juan Vázquez de Coronado, took special care when drafting the reports that would become the regnant theme of Costa Rica's colonial memory. Most notably, he followed very closely the new royal guidelines instructing conquerors to live in harmony with one another and to "attract" Indians to the faith. He also studiously avoided the vitriol that other conquerors had poured out in their reports to the king when relating the behavior of fellow Spaniards in the colonies. He dwelled on the "great love and benevolence" with which *he* treated Indian chiefs,

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of the nineteenth and twentieth centuries, see Tomás Ayón, *Historia de Nicaragua desde los tiempos mas remotos hasta el año 1852* (History of Nicaragua from the most remote times until the year 1852) (Managua: Tipografía de el centro-Americano, 1889); José Dolores Gámez, *Historia de Nicaragua desde los tiempos prehistoricos hasta 1860* (History of Nicaragua from prehistoric times until 1860) (Managua: Tipografía del país, 1889); Alemán Bolaños (fn. 32); Coronel Urtecho (fn. 32). See also José Coronel Urtecho's introduction to Ernesto Cardenal, *El Estrecho Dudoso* (The doubtful strait) (Mexico and Buenos Aires: Ediciones Carlos Lohlé, 1972).

[59] Meléndez (fn. 30), 41–47, 49.

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but he also downplayed intra-Spanish conflict.[60] And he enveloped his narratives in an almost technical aura, as when he very straightforwardly reported that his benign method of colonization proved "so efficacious that it was publicized throughout the land, and [that one Chief] . . . came to render obedience and to recognize his serfdom."[61]

These exemplary exercises in reportage, then, documented the ideal conquest —a conquest seemingly free of jealousies among conquerors and above all a conquest apparently accomplished without recourse to willful deceit or wanton violence against the natives. But there was more to rhetorical politics than the effectiveness of these particular reports. Several additional factors stand out. To begin with, this idealized rendition of the conquest went *unchallenged* because Costa Rica had no professional chroniclers, which meant that the rhetorical contentiousness that such professionals had introduced in prior conquests was now absent. Furthermore, there were no articulate defenders of Indians in the mold of the friar Las Casas or the bishop of Nicaragua. That is, there was no one to raise authoritative criticism when colonials deviated in practice from the letter of their self-serving reports[62] and/or disregarded the wishes of the crown.[63] The result was rhetorical hegemony at the critical point of Costa Rica's "founding" moment: the leading conqueror not only controlled the flow and substance of reports from the periphery to the metropole, but just as importantly his reports created an impression of *general* harmony.[64]

The impact these accounts had on the authorities in Spain, though important, was only secondary in significance to their impact on Costa Ricans themselves. Most notably, the unchallenged accounts provided the province's founding "nobles"[65] with an intangible but crucial resource: a good reputation. The nobles both exploited and cultivated this resource. They carefully observed—if only in appearance—the crown's increasingly sharp admonitions against violent conquest, most clearly

[60] José Francisco Trejos, ed., *Progenitores de los Costarricenses, Los Conquistadores* (The Costa Ricans' progenitors: The conquerors) (San José: Imprenta Lehmann, 1940), 34.

[61] For the original texts, see *Cartas de Relación Sobre la Conquista de Costa Rica* (Narrative reports on the conquest of Costa Rica) (San José: Academia de Geografía e Historia de Costa Rica, 1964).

[62] If anything, the first Franciscans to come to Costa Rica served as the "conquerors' right hand." Arnoldo Mora Rodríguez, *Historia del Pensamiento Costarricense* (History of Costa Rican thought) (San José: Editorial Universidad Estatal a Distancia, 1992), 64.

[63] There was, for example, no such controversy when the Costa Rican governor, a most obedient subject by his own account, actually ignored a royal ban on the allotment of Indians (a ban that forbade conquerors from distributing Indians among themselves).

[64] Francisco Montero, *Historia de Costa Rica* (San José: Tipografía Nacional, 1892), 40.

[65] The crown seldom granted titles of nobility in Spanish America, but this did not diminish the nobiliary pretensions of Costa Rica's conquerors.

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embodied in the Royal Ordinances of Pacification of 1573.[66] They extracted favors from the metropole on the grounds that their peaceful conduct left them exposed to the Indians' savagery![67] They staked a credible *common* claim to a privileged ancestral identity, which they then used to present a united front when dealing with Spanish officials. They played on the crown's high valorization of dutiful obedience to establish a de facto right to vocality in the selection of their Spanish governors.[68] And they asserted on the basis of (seemingly) meritorious conduct their own standing vis-à-vis governors, whom they eventually reduced to veritable subalterns.[69]

By the 1810s—a mere decade away from independence—Costa Rica's governors routinely pressed the nobles' agenda and accorded them the respect they craved; and the nobles, for their part, celebrated their governors as "protective fathers" whose "progressive" administrations promoted the province's tranquillity." Meanwhile, in Nicaragua (as in the rest of Central America) acrimonious relations between Spaniards and creoles destabilized the colonial order. The contrast merely emphasized Costa Rica's exceptional image—to the point that in a late-nineteenth-century retrospective it was said that while Costa

[66] Royal ordinances on "pacification," 1573, in Lewis Hanke, ed., *History of Latin American Civilization, Sources and Interpretations*, vol. 1, *The Colonial Experience* (Boston: Little, Brown and Company, 1973).

[67] Montero (fn. 64), 44.

[68] Ricardo Fernández Guardia, *Crónicas Coloniales* (Colonial chronicles) (San José: Imprenta Trejos Hnos., 1921), 517.

[69] For power relations in colonial Costa Rica, see Cruz (fn. 37), 85. Reputation building, of course, took place within particular institutional contexts. Costa Ricans, for example, had no institution of higher learning. (Any Costa Rican seeking enlightened cultivation had to study either in Guatemala City or in Nicaragua, at the seminary in León). This deficiency, though lamented by the nobles themselves, meant that no institutional framework was available for the elaboration and recording of narrative challenges to the nobles' exceptionalist account of conquest and colonization. In Nicaragua, meanwhile, the seminary helped entrench the "fall from grace" view of history. The seminary, for example, opened up to the novel philosophies and political theories coming out of Europe and the United States but then molded them to the Christian worldview. Leon's "sacred orators," for example, strove in the late eighteenth century and the early decades of the nineteenth to reconcile the progressive spirit of the Enlightenment with the immutable truths of the Christian worldview. And even as independent intellectual clubs began to form in the late nineteenth century, the church's influence remained sufficiently strong to extirpate revisionist interpretations of the bishop's murder. The short-lived counternarrative of the murdered bishop as victim of "his own arrogance" and the restoration narrative in which the bishop once again figured as a victim of "vile conquerors" were both penned by liberal notables associated with the city of León. This brief interpretive conflict and its swift resolution reflected the long-standing institutional entwinement of León's educational elites and the church qua guardian of hierarchical orthodoxy. For early examples of this entwinement, see "Discurso," pronounced at the León seminary, May 16, 1807. See also "Sermón," delivered by Tomás Ruiz, professor of philosophy and vice-rector of the seminary, November 27, 1804; and "Sermón en los Funerales del Padre Don Rafael Ayesta," delivered by Francisco Ayerdi, both reproduced in *Boletín Nicaraguense de Bibliografía y Documentación*, no. 55 (November 1987/September 1988).

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Rica had been the crown's most neglected territory, in no other had the metropole been "better loved."[70]

This seemingly fluid and happy memory, as we have seen, was grounded in a particular process of memory construction and reputation building that produced a power structure in which royal officials became the local elite's junior allies. In the next section we will see that, paradoxically, it was precisely this happy memory that introduced *competing* notions of realism into Costa Ricans' postcolonial field of imaginable possibilities.

V. Alchemists and Fatalists at Work

The keenly competitive political leaders who emerged on the scene in postcolonial Costa Rica (1821) were quintessential political entrepreneurs. But they were soon in a bind precisely because—unlike the Nicaraguans—they perceived more than one possible route to power. One available option was simply to follow the Central American example; that is, Costa Rican leaders could compete with each other by riding high on the tide of localism. This was the politically easier but bloodier route because it called for each rival leader to try to impose the predominance of his respective locality at the expense of the others. The other option was less costly in terms of lives but was more complicated in a context of heightened localism: rival leaders could compete for political dominance by exploiting Costa Ricans' colonial self-image as a poor but peaceful people. Costa Rican political entrepreneurs experimented briefly with both options, one moment jockeying for localist preeminence, the next proposing that all localities band together behind one locality in order to keep at bay the "fratricidal" wars convulsing the rest of the isthmus.

Neither option prevailed; just as one gained relative salience the other recovered strength. In turn, this unresolved competition engendered ambivalence among political entrepreneurs—an ambivalence they transcended through intense contestation, which then produced yet a third alternative. Specifically, entrepreneurs set out to conciliate two opposing objectives: assuring collective insulation from external disruption *and* vindicating internal localist claims. Eventually, they

[70] Francisco Montero Barrantes, *Elementos de Historia de Costa Rica* (San José: Tipografía Nacional, 1892), 153. And Francisco María Iglesias, "septiembre 15" (San José, September 15, 1888), in *Revista de Costa Rica en el Siglo XIX* 1 (San José: Letras Patrias no. 32); and Máximo Soto Hall, "Capítulos de un Libro Inédito," in *Revista de Costa Rica en el Siglo XIX* 1, 87.

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came to see reconciling of these two objectives as the sine qua non of political success. Indeed, the imperative for conciliation proved binding because, by operating within the parameters of what they thought was realistic, political entrepreneurs further reconfigured their collective field of imaginable possibilities.

This process of reconfiguration began when competing leaders actually managed to forge a foundational compromise known as the Pact of Harmony (1821). One of the pact's crucial provisions was the institutionalization of an itinerant national government: high officials were obligated to reside in each of the country's four major cities for part of every year. The peculiar arrangement did something unprecedented in the rigidly hierarchical colonies: it divided up equally the prestige and power attached to the seat of government. The argument advanced in favor of this curious arrangement was derived, ironically, in part from Costa Ricans' understanding of their unique colonial experience, as, political entrepreneurs concluded that Costa Rica's long tradition of internal harmony could be preserved from external threat only if all domestic localist claims were satisfied in some equitable fashion.

The arrangement was also fragile, of course. In 1823 and 1835 there were armed encounters between rival localities, with each trying to establish its own predominance by destroying the arrangement itself. But these conflicts were also very quickly resolved. Hostilities in 1823, for example, lasted no more than a few hours, while similar localist conflicts went on for years in the rest of the region. More important still, the pact that encoded the arrangement proved quite resilient. In fact, over time, the Pact of Harmony became the emblem of Costa Rica's exceptionally peaceful transition to the national era, even taking on a numinous quality not unlike that of the U.S. Constitution.

To understand the pact's resilience—and its beneficial effects—we must now turn our attention to the rhetorical practices associated with the declarative process of identity formation. These rhetorical practices hinged on a series of "realistic" assertions about Costa Ricans' place in a dangerous world made by political entrepreneurs trying to capture allegiances. These assertions emphasized their people's unique capabilities and weaknesses. In 1822 the country's first governing junta declared peace to be "virtually innate" to Costa Ricans because their colonial ancestors had adhered to a "sacred religion" that consisted of a "characteristic unity of opinion and calm."[71] The first chief of state (1824–33)

[71] "Proclama de la Primera Junta Superior Gubernativa al Terminar su Período," Alajuela, November 9, 1822, in Carlos Meléndez Chaverri, ed., *Documentos Fundamentales del Siglo XIX* (Fundamental nineteenth-century documents) (San José: Editorial Costa Rica, 1978), 93–94.

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helped bolster this assertion, as did the State Assembly.[72] The legislature declared that while Costa Ricans were "poor," riches were in store for them because they were "industrious," "calm," and "patriotic." And reflecting deep concern over Nicaragua's relentless upheaval, the assembly proclaimed in 1825 that if Costa Ricans guarded against the "corruption of their mores," they would enjoy "eternal and exemplary tranquillity."[73] For his part, the executive vowed to "draw" on the "virtues, morality, and good sense" of his compatriots. Only distance, he told them, would allow their small and weak country to maintain "public peace." Only peace, he added, could afford them "the time" to devote themselves to "business." And only in distant peace, he concluded, could they enjoy the "fruits of their labor and investments."

Thus, while in the rest of Central America clashes between these two branches of government over institutional predominance often led to war, in Costa Rica the branches outdid each other in their praise of the Costa Rican "people." But they did more. In 1825, they set out to provide the country's "virtuous people" with land via their first agrarian reform. This decision to begin distributing uncultivated tracts turned out to be the first step in what would become a concentrated effort to promote the production of coffee: from 1840 on, governments pursued a policy of free land distribution for that purpose.[74] But the reform was also meant to demonstrate the capacity of "humble" Costa Rica to defy expectations and single-handedly preserve its reputation and integrity. In 1827 the Costa Rican government declared that

> Costa Rica, which at every point has given unequivocal proof of its love for peace, order, and law . . . contemplates in horror the rapid degradation of the [Central American] Republic . . . the virtuous people of Costa Rica, notwithstanding their territory's small scale and the obscurity in which they have lived, and in spite of the erroneous and disdainful opinion about them held by others, have proved *capable* at the most critical points of surviving and retaining a *sense of self* without subsidy or assistance from their [Central American] siblings.[75]

This optimistic assessment proved correct, in no small measure because the strategy of matching factors of production—"virtuous"

[72] Astrid Fishel Volio, "La Educación en el Proceso de Formación y Consolidación del Estado Costarricense," in Gómez et al. (fn. 35), 129–52.

[73] "Manifiesto de la Asamblea del Estado," San José, April 19, 1825, in Meléndez Chaverri (fn. 71), 135–36.

[74] Torres Rivas (fn. 34), 17.

[75] Joaquín Bernardo Calvo, "Nota del Ministro General del Estado de Costa Rica al Ministro de Relaciones Interiores y Exteriores de la Federación," San José, October 8, 1827, in Meléndez Chaverri (fn. 71), 147–50, emphasis added.

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human capital with uncultivated lands—paid off. By 1829 the executive was able to report that the country had managed to make steady progress in commerce, agriculture, and mining, while "enterprises, profits, and consumer goods" multiplied.[76] But at the same time, there were ominous signs no one had anticipated. Most notably, by 1831 the administration had accumulated a budget deficit that, in the eyes of the opposition (concentrated in the city of Cartago), imposed an unbearable "burden" on all the people.

Anywhere else in Central America this harsh indictment, in combination with intense localist pressures, would have been sufficient reason for immediate confrontation. But the Costa Rican opposition, while localist in its biases, pushed instead for the creation of a special commission to investigate the nation's fiscal problem. Once formed, the commission itself faced a menu of options. It could opt, for example, to press for a straightforward fiscal austerity plan or to recommend a deepening of the state's extractive capacity. Instead, the commission took the tack of arguing that the best way to increase the state's resources was to make citizens "rich," on the grounds that the state's fiscal soundness was inextricably tied to society's "general prosperity."[77]

The reasoning behind this position is instructive. Fiscal impositions were deemed problematic because they "exasperated" a people that had long sacrificed to keep its domestic "tranquillity." This was key, since tranquillity was considered the "sole support" of Costa Rica's "political viability." The commission elaborated on this last point by noting that "discontent and upheaval" in Costa Rica were an "uncharacteristic" state of affairs, whereas peace and industry were the country's very essence.[78]

This last assertion represented a critical shift in perceptions. Once convinced that their poverty under the colonial regime was a fact of life, Costa Ricans now took decisive steps to lift their country out of its "misery." In crafting its developmental plan, the commission produced a statement that was as much a chart for the future as it was a declaration of faith in the Costa Rican people. Costa Ricans, the commission noted, were eager to contribute to the welfare of the "republic." Land, however, was useless without credit, and the Costa Ricans' "good disposition" was wasted without employment opportunities. Nor could the

[76] Juan Mora, "Mensaje del Jefe de Estado a la Asamblea," San José, March 1, 1829, in Meléndez Chaverri (fn. 71), 150–57.

[77] "Dictámen de la Comisión para recabar arbitrios," Cartago, August 15, 1831, in Meléndez Chaverri (fn. 71).

[78] Ibid.

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nation move forward if its leaders' hopeful utterances lacked credibility with the people. "Without wealth or credit, we cannot make credible promises of happiness and political viability," the commission stated, before going on to dispense one key piece of advice: grant titled plots of land to the poor, especially along the coasts. By the commission's logic, only "good titles" could establish a "spirit of good faith among citizens," and only in this way could Costa Ricans avoid "fights" over "what belongs to whom, and who owes what." No entity other than the state could provide this essential public good.[79]

The commission's plan, no doubt, was also a trenchant critique of the government in power. But the critical point here is the following: the more Costa Rican politicians expressed themselves in this way, even for self-seeking purposes, the more they unwittingly tied each other to the controlling notion that Costa Rica's status as a regional exemplar must be preserved at all costs. As one leader put it:

> Costa Rica has set a good example in every respect for the other states of the [Central American] republic. It is neither reasonable nor just that Costa Rica should now lose the beautiful prestige that it has earned through its constant vigilance in the protection of harmony, its exact adherence to the law, and its continuous repudiation of the partisan rows and personalist ideas that have been in abundant evidence in the other states.[80]

Further, Costa Rican politicians fell increasingly prey to the fear of contamination implicit in this 1830 statement. By 1835 dread of a Nicaraguan "infection" was very much in the open.[81] This is not surprising, given that the partisan rows and personalist ideas that Costa Ricans had repeatedly declared to be alien to their character were nevertheless resurgent in the country. In fact, the leaders of the various Costa Rican localities were on the verge of battle over the issue of national predominance. Nevertheless, in 1835, as in 1823, this conflict was very quickly resolved, thanks to three factors. One was the preponderance of force enjoyed by the city of San José. Another was the conciliatory pressure exerted by the hallowed Pact of Harmony on rival politicians (thus precluding triumphalist intransigence on the part of San José). And the third, related factor is that prior to the outbreak of hostilities, opposition leaders had outlined a developmental plan rooted in widely held expectations about what the future could and should

[79] Ibid., 481-85.

[80] José María Esquivel, "Sobre la Disolución de las Costumbres," San José, May 15, 1830, in Meléndez Chaverri (fn. 71), 474–75.

[81] "Manojito de Flores", *El Josefino*, San José, August 11, 1835, in Meléndez Chaverri (fn. 71), 485–88.

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look like. In so doing, they had established a focal point for a postconflict working compromise, and generated powerful incentives for victors and vanquished alike to resume the business of growing the economy and protecting the nation's defining principles.

These incentives, in fact, further accentuated the pressure that rivals and allies alike put on incumbent executives to take quick and effective developmental action: hence the overthrow of an inadequate chief (1838) and the feverish pace and extensive scope of his successor's initiatives. In addition to building roads and ports to support large-scale coffee production and trade, the new chief (Braulio Carrillo) established civil and penal codes, a postal service, and a national defense apparatus—measures that culminated in the self-confident decision to separate Costa Rica from the Central American Federation.[82] Moreover, Carrillo fostered broad-based agrarian development while entrenching the elites' socioeconomic dominance. Starting with his administration, national governments systematically pursued a policy of free land distribution for the cultivation of coffee. (They also maintained a pyramid-like distributional structure. By 1850, with the coffee boom in full swing, "three quarters of all major coffee growers were descended from just two Spanish colonial families, one of them that of the conquistador Juan Vázquez de Coronado himself.")[83]

These accomplishments were so impressive that Carrillo was emboldened to expand the limits of executive authority. Pointing to his own record of effective leadership, he declared himself ruler for life. But as Juan Linz has observed, performance-based legitimacy, unlike procedural legitimacy, is not self-reproducing. That is, if the ruler fails to keep his programmatic promises, then he is simply not needed. And if he does keep his promises, he may not be needed anymore. Given additional time in office, Carrillo might well have attained new and impressive goals. But having accomplished so many already, he made himself dispensable and was forced out of power in 1842.

And yet, overcoming internal cleavages, political leaders ultimately vindicated Carrillo as a historical figure. This vindication process reached its crowning point in the 1970s, when Carrillo was officially named "benemérito de la patria"—worthy and deserving of the fatherland. But the vindication process had begun already in the second half of the nineteenth century. Depictions of Carrillo as a special kind of authoritarian became more frequent, as he was described as a firm and pa-

[82] Montero Barrantes (fn. 70).
[83] Paige (fn. 41), 15.

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triotic ruler under whose wise leadership Costa Rica "grew accustomed" to "self-government" and "complete independence." And his accomplishments and reputation came increasingly to be tied to the larger theme of Costa Rica's collective virtuousness.[84]

Given the Costa Rican leaders' emerging understanding of their postcolonial history, the exaltation of Carrillo is not surprising. Specifically, leaders came to see this history as a series of character tests, each a challenge that had called on Costa Ricans both to reveal and to defend their true collective self. At every point since independence, in this account, Costa Ricans had to prove themselves anew as a "hard-working, pacific people, dedicated to agriculture and devoted to commerce." And at every point they confronted the fact of Nicaraguan neighbors, "possessed of many good and brilliant qualities" but "generally indolent, accustomed to internal strife, and inclined to fight with neighboring states." So that while in its territorial disputes with Nicaragua, Costa Rica had invariably remained "patient," "sacrificing," and "conciliatory,"[85] it was also the case that from a purely defensive perspective Carrillo's strong rule had been "necessary."[86]

By 1850 this view of the past, with its clear descriptive and prescriptive lines, had become an integral part of the dominant rhetorical frame. This frame shaped rivals' rhetorical strategies and their competing programmatic initiatives. This meant that rivals explained their designs and justified their actions by making vehement reference to the constitutive elements of identity, engendering in the process a collective field of imaginable possibilities. Put another way, rivals embedded themselves in a structure that helped define realism while imposing normative constraints on actors' self-seeking pursuits. From the mid-

[84] Emanuel Thompson, *Defensa de Carrillo: Un Dictador al Servicio de América* (In defense of Carrillo: A dictator at the service of the Americas) (San José: Imprenta Barrase, 1945).

[85] Felipe Molina, *Memoria sobre las Cuestiones de Límites que se versan entre la República de Costa Rica y el Estado de Nicaragua* (Record regarding border matters under discussion between the Republic of Costa Rica and the state of Nicaragua) (Madrid: Imprenta de la Viuda de Calero, 1850). Also refer to Pedro Pérez Zeledón, minister plenipontentiary to the United States, *Informe Sobre la Cuestión de Límites de Costa Rica y Nicaragua y Puntos Accesorios Sometidos al Arbitraje del Señor Presidente de los Estados Unidos* (Report on issues regarding the border and points of access between Costa Rica and Nicaragua, submitted to the president of the United States for arbitration) (Washington, D.C.: Gibson Bros., 1887).

[86] Molina (fn. 85), 25–26. For Costa Ricans' perception of the Nicaraguan threat, see *Documentos relativos a la guerra contra los filibusteros*, Document no. 215. For an account in which Carrillo's "prodigious" and "broad" contributions to "the nation's progress" ultimately redeem him as a historical figure, see the constitutional scholar Jorge Sáenz Carbonell, *El Despertar Constitucional de Costa Rica* (Costa Rica's constitutional awakening) (San José: Libro Libre, 1985), 362–70, 378. For a complete defense of Carrillo, see Thompson (fn. 84). For praise of Carrillo as the "true enlightened despot" who, playing a role similar to "Rousseau's supreme legislator," begins the construction of the sovereign state in Costa Rica, see Mora Rodríguez (fn. 62),118–19.

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nineteenth century until the democratic revolution of 1948, political entrepreneurs occasionally imposed and deposed rulers and often manipulated electoral processes. But throughout all of this, they were also subjected to particular standards of performance that simultaneously entrenched Costa Rica's "exceptionalism," minimized political conflict, and deepened the developmental ethos of competing leaders. Moreover, throughout all of this, elites implicated the citizenry in the production and legitimation of power relations, promoting the emergence of a public sphere in which rulers and the people celebrated—shoulder to shoulder—the nation's civic traditions and ultimately affirmed the legitimacy of state authority.[87]

Conditions could not have been more different in Nicaragua, where immediately after independence localist and personalist leaders sparked a civil war (1823–24, 1827)[88] so intense and engulfing in scope that it was characterized as a horrifying display of fratricidal butchery by the Central American government.[89] This conflict is intriguing for its sheer intensity and displays of barbarism. But even more puzzling is the fact that although neighboring Costa Ricans had begun to show that divisive jealousies could be controlled (albeit imperfectly), Nicaraguans seemed bent on spoiling possible solutions to their destructive power struggles. Why was this the case?

The most important reason for this outcome is also the most counterintuitive: because Nicaraguans had no "happy" collective memory on which to draw in a context of rampant localism, they were free from the ambivalence that competing possibilities engendered among their Costa Rican counterparts. And so while Costa Rican political entrepreneurs felt compelled to apply their powers of persuasion to reconciling the available options—something they ultimately managed by emphasizing the common virtues and capabilities of their people—Nicaraguan entrepreneurs faced no such imperative. This is not to say that the construction of Nicaragua's dominant rhetorical frame was ei-

[87] See Margarita Silva, "Las Fiestas Civico-Electorales en San José Y El Reconocimiento de la Autoridad de Los Elegidos," in *Revista de Historia*, no. 27 (January–June 1993).

[88] For the localist and clannish rivalries underlying this conflict, see José Coronel Urtecho, *Reflexiones sobre la Historia de Nicaragua: de Gainza a Somoza*, vol. 1 (Reflections on the history of Nicaragua: From Gainza to Somoza) (León: Editorial Hospicio, 1962); José Dolores Gámez, *Historia de Nicaragua* (Managua: Fondo de Promoción Cultural, Banco de América, 1975); and José Coronel Urtecho, "Paradojas de las Intervenciones de Valle y Arce en Nicaragua," *Revista Conservadora del Pensamiento Centroamericano* 28 (May 1972).

[89] *Revista de la Academia de Geografía e Historia de Nicaragua* 6 (April 1944), 181–85; and "Discurso" pronounced at the Ateneo, September 15, 1881, in *Revista Conservadora de Pensamiento Centroamericano* 2 (July 1961).

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ther entirely open or entirely foreordained. It was not entirely open because actors experienced rhetorical freedom—in a particularistic and immediate sense—in part because their only stable referent was a colonial experience that presumably offered nothing but strife and "treachery." And it was not entirely foreordained because, as in Costa Rica, political leaders were keenly alive to shifting opportunities and made critical choices accordingly.

As in Costa Rica, so too in Nicaragua, the interplay of agency and legacies was in evidence from the start. Take the case of electoral competition. In Nicaragua, as everywhere else, elections were meant to resolve conflicting claims to national dominance. But instead elections merely raised the already high levels of mistrust, a counterproductive effect that reflected rivals' Manichaean expectations. Thus, rivals expected electoral mechanisms, if uncorrupted, to reward the virtuous with victory even as they perceived one another as "wicked men" bent on corrupting electoral processes and controlling electoral outcomes. Indeed, in the face of their rivals' "perverse" motivations, leaders typically concluded that elimination of the foe was a prerequisite for elections. And when elections—secured by outside mediation—finally took place, even national-level winners tried to modify adverse results at the local levels.[90]

Moreover, rivals understood that persuading followers to go to war prior to elections or otherwise risk the turmoil associated with ex post interference with electoral outcomes required a rhetorical strategy that would drive home the point that these were unavoidable measures, given the harsh realities of their world. To this end, political entrepreneurs shifted the target of rhetorical campaigns away from a now irrelevant royal sovereign to *El Público* (the public). Here, the rhetoric political leaders bandied about is instructive. Rivals invariably characterized one another's utterances as "slanderous" and "malicious fictions." They invariably depicted each other as "monsters," "bloodthirsty," and "denaturalized." And just as invariably, they ascribed to their actions an evil intent: to "bewitch" and "daze" the "naive" and "innocent" public with their eloquence.[91]

[90] Elections were first held for deputies and for the top executive positions of chief and vice chief of state soon after Nicaragua was "pacified" in 1825 through the diplomatic intervention of Manuel José Arce (with the backing of his Salvadoran troops). Significantly, one of the terms of the peace agreement was the exile of the popular caudillo Cleto Ordoñez, whose *extraordinary eloquence* was considered a destabilizing force.

[91] "Un Nicaraguense," "Relación del Origen y Progreso de la Revolución del Estado de Nicaragua," May 10, 1827, *Revista de la Academia de Geografía e Historia de Nicaragua* 2 (September, 1937), 43; "Proclama de Juan Arguello sobre los sucesos de Guatemala en 1826," Libro de actas municipales de León, 1826, *Revista de la Academia de Geografía e Historia de Nicaragua* 1 (1936–37), 69–70.

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In other words, they exploited the old colonial belief that the "wicked"—artful and conniving—"duped" the sovereign.[92]

The rhetoric of political entrepreneurs was also self-directed. Rival leaders strove to persuade themselves and each other that the Manichaean worldview they propounded was not only descriptive but also prescriptive. And indeed, by describing the world in such starkly negative terms, they put in place equally dark rationales. Cleansing the government of internal suspects, for example, was justified on the following grounds. First, a legitimate election is invalidated when, ex post, an elected official engages in "diabolical plots." Second, such plots reveal a "depraved spirit." And third, once revealed, the truth empowers the "valiant sons" of the *patria* to rescue her from a "perfidious" incumbent.[93]

In making this case, competing entrepreneurs generated a vicious cycle: attacks bred counterattacks ad infinitum. By the 1830s Nicaragua seemed to confirm the pessimistic expectation articulated by one Central American notable:

> If no punishment is set for those who slander in newspapers, those who have been slandered retaliate in kind; nations become uninhabitable. From one libel we go to another. Vengeance leads to the spilling of blood; and political societies succumb to chaos, death, and horror.[94]

The 1840s in Nicaragua were indeed characterized by episodes of partisan/localist violence and petty despotism. But these episodes were also punctuated by efforts at political learning. Some leaders argued that decades of "mutual disdain" and "killing" ought to have taught Nicaraguans two lessons. The first concerned the true nature of republican government, which, as the argument went, ought to be properly understood as citizens coming together in perfect unity to resist the "wicked."[95] The second lesson concerned freedom of expression. Here the message was that the individual's opinion must be subordinated to the pursuit of the collective welfare, a priority that required orators and pamphleteers to eschew exploitation of the "people's naive simplicity."[96] These two lessons combined to reinforce the view of the "popular sovereign" as "ignorant" and "pliable," while investing Manichaeanism with

[92] Manuel Antonio de la Cerda, "A Ciudadanos Secretarios de la Asamblea Constituyente," León, May 10, 1825, and May 19, 1825. *Revista de la Academia de Geografía e Historia de Nicaragua* 1 (1936–37), 255–56.

[93] *Revista de la Academia de Geografía e Historia de Nicaragua* 6 (1944), 155–56.

[94] "Discursos pronunciados en el Congreso Federal de Centroamérica el año de 1826, por José del Valle," *Anales de la Sociedad de Geografía e Historia de Guatemala* 2 (December 1925).

[95] For a typical statement, see *Registro Oficial* (March 1845).

[96] See, for example, José León Sandoval's broadsheet *Al Público* (Managua), September 22, 1846.

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the ideological authority of republicanism. The effect was predictably polarizing: political entrepreneurs claimed for themselves the identity of ideological sophisticates bent on extricating the country from its "backwardness," and on this basis they then set out to remove the "little pueblo" from the rhetorical influence of "intrigue mongers."[97]

By the 1850s the country's political leaders were beyond reconciliation. In fact, dispossessed of any unifying perception of their common capabilities or a binding vision of national integrity, they were even ready to deliver themselves into the hands of the adventurer William Walker. All they had was a Manichaean worldview that reaffirmed the spreading perception of Nicaragua as an ill-fated nation. And so, as one ardent liberal put it, the hope was that the foreigner might act as "the tutelary Angel of Peace, and the North Star of the aspirations of an afflicted people."[98]

High instability and profound despondence overwhelmed early attempts by state elites to engage in concerted developmental efforts. In a brief moment of relative quiescence, for example, the State Assembly recognized that land—an abundant resource—could "take on value" only if placed within a proper incentive structure (1832). Accordingly, the assembly reaffirmed prior constitutional commitments to *ejidal* (communal) lands, and gave *ejidos* to towns, in hopes that "public happiness," "rural industry," and a class of "proprietors" would all thrive and bring about an improvement of popular "customs" and a stronger state.[99] But these donations notwithstanding, the development of agriculture in general and the cultivation of coffee in particular took their own spontaneous (and in the case of coffee, very slow) course until the late 1850s. This was no accident. Political elites were able to organize the state and bring political stability to the nation only after the establishment of the Conservative Republic, which for thirty years incrementally enhanced intraelite consensus and bipartisan cooperation.[100]

[97] For a representative statement, see the broadsheet published by Granada notables, *Al Público* (Granada), July 11, 1848.

[98] Francisco Vigil, *Manuscritos auténticos compilados, Padre Vigil* (first published in Granada, 1930; privately reprinted in Managua, 1967), 119–22.

[99] Julie A. Charlip, "'So That Land Takes on Value': Coffee and Land in Carazo, Nicaragua," in *Latin American Perspectives* 26 (January 1998).

[100] Put another way, the late development of the Nicaraguan coffee economy was rooted in political-institutional factors. One seemingly compelling alternative possibility—that late development of the coffee economy was due to structural factors like preexisting landholding patterns—is challenged by recent scholarly research. Large tracts of indigenous *ejido* (communal) holdings, for example, did not obstruct the early spread of coffee production in Nicaragua. To the contrary, as Charlip (fn. 99) has shown, ejidal lands allowed for the ubiquitous subsistence economy that sustained the coffee economy's *seasonal* labor force (pp. 2–5).

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The puzzle that arises at this point, of course, is the republic itself—a puzzle that I have considered in detail elsewhere.[101] Suffice it here to say that both the republic's viability and eventual implosion were closely related to significant but ultimately fragile adaptations in the polity's rhetorical culture and attendant shifts in the field of imaginable possibilities. One adaptation in rhetorical convention stands out. Presidential incumbents were expected to remove their voices from partisan and localist exchanges and were therefore denied vocality in the most explosive rhetorical spaces of the public realm. Indeed, presidents not only practiced but even "declared" silence on such matters, thus explicitly disassociating their formal (constitutional) authority from their informal (rhetorical) power.[102] This disassociation diminished traditional elite fears that the executive might combine authority and power in order to monopolize the support of the "popular sovereign" and, by extension, arrogate excessive prerogatives unto himself.

This change in rhetorical convention and practice brought about a shift in the field of imaginable possibilities. Specifically, as fears of excessive concentration of executive power were assuaged, power sharing came to be perceived by antagonists as a realistic proposition. This crucial shift, in turn, had concrete political consequences. For if power could truly be shared, then bipartisan agreements and supralocal arrangements were no longer understood ipso facto as ploys of opponents. Nor was cooperation among rival leaders and localities necessarily seen as a betrayal of principle and interests.

The proximate causes of the republic's implosion reveal the underlying precariousness of these important changes. To begin with, failure by even one incumbent to adhere to the rule of declared silence could compromise the republic's entire institutional framework. In the early years of the republic this danger was minimized by careful selection of presidential candidates. But as the republic appeared to consolidate, dominant elites moved to enlarge the candidate pool. In so doing, they also enhanced the chances of electing a wayward president. And indeed, the republic imploded in the late 1890s. Then for the first time a notable associated with the city of León rose to the presidency of the republic, which for decades had been led by notables from the rival city of Granada and its satellite towns. Leon's notables declared the election a historical vindication for their city. But other localist forces, also present within the republic's institutions, balked at this interpretation.

[101] Cruz (fn. 1).

[102] See, for example, "Manifiesto de S.E. el Presidente D. Fernando Guzmán a los Pueblos de la República," (n.p.: Imprenta del Gobierno, 1867).

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Governance quickly degenerated into acrimonious disputations in which the new president himself was a vociferous participant. Soon enough the republic was torn apart from within by mistrust, mutual recrimination, and subversive plots.[103]

The revival of the Manichaean frame that accompanied and followed the republic's crisis shows something else, that an expansion of the field of imaginable possibilities based on silence, however explicit this silence may be, is not the same as expansion based on fundamental and explicit discursive shifts. Because the republic left no clearly articulated alternative vision of the possible, for example, new generations of political elites and historians of various partisan affiliations and ideological stripes concluded that the republic itself was an "anomaly" in Nicaraguan history. Indeed, the republic became the antithesis of historical "normality," with the normal state of affairs defined as a perpetual oscillation between "anarchy" and "tyranny." Moreover, within this calamitous field of imaginable possibilities, the best hope lay with a strong, enlightened leader who might emerge to impose on the intractable nation a common quest for "order and progress."[104] Dictators did emerge, of course. But they also generated opposition—opposition that often returned to the conquest for its terms of reference, as when in the 1970s the anti-Somoza poet Ernesto Cardenal wrote that Nicaragua's founding (and evil) conqueror had been its first "dictator" and the first to "promote progress" (for himself).[105]

The case of Costa Rica stands in sharp contrast. Costa Rican self-invention proceeded in stages, with each stage borrowing from the prior one. In the 1880s, for example, political elites successfully used postcolonial exceptionalist claims to build the Liberal Republic. As a result, from the early decades of the twentieth century to the turbulent 1940s the country's "republican tradition" and "exceptional character" served as focal points for reformist debates involving a wide range of issues—from democratization of the electoral system to stabilization of agrarian relations. Even the crisis of the First Republic—culminating in the Civil War of 1948— hinged on political actors' contending interpretations of how best to preserve the glories of the past. Moreover,

[103] See also Arturo J. Cruz, Jr., "Overcoming Mistrust: The Quest for Order in Nicaragua's Conservative Republic, 1858–1893" (Ph.D. diss., University of Oxford, 1997).

[104] This was the hope that led liberal intellectuals at the close of the nineteenth century to rally around José Santos Zelaya. And this too was the hope that in the 1930s led modernizing intellectuals, even some who later became renowned critics of the Somoza regime, like Pablo Antonio Cuadra, initially to support Anastasio Somoza García.

[105] Ernesto Cardenal, *El Estrecho Dudoso* (The doubtful strait) (Mexico City and Buenos Aires: Ediciones Carlos Lohlé, 1972), 75.

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the rhetorical settlement imposed by the 1948 victors tied the legitimacy of the Second Republic to the "redemption" and "improvement" of the First Republic's legacies. Indeed, the victorious leader José Figueres explicitly labeled the turbulent period of 1942 to 1949 as an "aberration" in Costa Rican history—a rhetorical move with several important implications. First, as Figueres himself contended, even his own armed rebellion and extraconstitutional junta could be deemed justifiable only in a context of "abnormality." Second, as Figueres further argued, now that Costa Rica had returned to the normalcy of its "inherent" civility and its "natural" democratic course, any new attempts at rebellion and extraconstitutional rule would be deemed unacceptable affronts to the nation's identity.[106] This last point was particularly important given the controversial nationalization policies of the new regime (and the new leadership's need to justify the smashing of reform counterthrusts). Third, since the 1948 revolution legitimated itself by claiming continuity with the country's "best" legacies, political rivals were gradually forced to craft new rhetorical strategies that (re)integrated pre-1948 elements of collective memory—elements that were no longer contestable and thus had a stabilizing effect on post-1948 elite competition. (During the increasingly trying decades of the 1970s and 1980s, for example, politicians of various partisan affiliations appealed to the citizenry for political support and peaceful unity by [1] invoking the exemplary behavior of their "benign" conquerors; [2] rehearsing the nation's "exceptional" transition from the colonial to the postcolonial era; and [3] exalting the early postcolonial Pact of Harmony.)[107]

Conclusion

In this article I have argued that collective identity is a robust declarative statement that a group makes, under the pressure of collective memory and contextual forces, to itself and to others about its normative constitution and its practical competence when facing the world. A normative constitution mandates what a group cannot or will not do out of deference to its self-defining convictions and sense of viable justice. Practical competence, in turn, refers to the group's intersubjective assessment of

[106] "La orientación general de la Segunda República," José Figueres, opening speech, constitutional assembly, January 16, 1949; and José Figueres, *Cartas a un Ciudadano* (Letters to a citizen) (San José: Editorial Universidad Estatal a Distancia, 1980).

[107] For striking examples, see José Manuel Salazar Navarrete, *Oduber, Elección Presidencial de 1974* (Oduber, presidential election of 1974) (San José: EDARASA, 1978); and Luis Alberto Monge, "Proclama de neutralidad," Presentación hecha en el Teatro Nacional, November 17, 1983.

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its common capabilities and weaknesses. A dominant rhetorical frame is the mechanism that connects the two, in war as in peace.

I have also argued that although political actors are endowed with significant powers of initiative, actors' own rhetorical struggles can destabilize their purposive aims and alter their legitimate claims to power. Such struggles can even bring about shifts in a particular field of imaginable possibilities. These shifts either restrict or enhance actors' perceptions of their "realistic" options as they go about the business of connecting their self-seeking pursuits to their group's beliefs and expectations. In postcolonial Costa Rica, for example, competing elites deployed the memory of a "happy" colonial experience in order to garner support for their own particularist agendas. In so doing, they diminished their own chances at particularist dominance and improved the prospects for national unity and a common developmental agenda. Conversely, Nicaraguans sought unity by deploying a Manichaean colonial narrative that opened up ample space for self-seeking pursuits but eroded the foundations for consensus building and sustainable developmentalism. These divergent outcomes call into question, among other things, Anderson's view of national-identity construction as a process of "fraternal" imagining that obtained uniformly across postcolonial Spanish America.[108]

Finally, I have argued that to understand these contrasting outcomes, we must identify the rhetorical frames and the fields of imaginable possibilities that shape political identities and structure political competition. Only in this way can we explain why political entrepreneurs sometimes cultivate preexisting suspicions and conflicts and at other times act as innovative conciliators. Which path political entrepreneurs follow is of momentous importance. For postcolonial Costa Rica it meant relative political civility and early economic progress. For postcolonial Nicaragua it meant political-economic ruin. In the latter, even now, rampant mistrust and leaders' preemptive attacks on one another undermine the country's incipient democracy—one moment paralyzing major governmental institutions, the next provoking the feverish rounds of public graft that deepen popular disenchantment. Yet in both cases the lesson for political analysts and practitioners is the same: *how* we remember shapes *what* we can imagine as possible.

This means that there are no quick fixes for the noxious sentiments and the barbaric strife that often accompany identity-driven clashes. Improving the chances for pluralist peace in conflict-ridden societies

[108] Anderson (fn. 26).

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requires more than changing the leadership, reforming formal institutions, or developing schemes for coexistence, important as all of these can be. It requires making critical entrepreneurs of us all: discerning citizens capable of distinguishing between history and fate. This must be the work of the village school and the think tank, the historiographer and the visionary. In some cases patient and careful foreign assistance or even enforcement may be useful. But the objective is always the same: deny exploitative entrepreneurs the ring of truth.

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THE CAUSES OF WELFARE STATE EXPANSION
Deindustrialization or Globalization?

By TORBEN IVERSEN and THOMAS R. CUSACK*

INTRODUCTION

IT is commonplace to argue that the increasing openness of national economies has meant growing economic insecurity. This insecurity once supposedly fueled demands for larger welfare spending as a form of insurance.[1] The rising tide of globalization, however, is now widely seen as a hinderance to a government's ability to meet these demands and even as a cause of government cutbacks.[2] An alternative view combines this "second image reversed" with a concern for the political power of labor and the left.[3] This revisionist perspective suggests that the challenges promoted by globalization when met by strong left-labor power within the domestic political system combine to produce a compensation strategy that entails a large and vibrant welfare state. This paper challenges both these views. Our argument, in short, is that most of the risks being generated in modern industrialized societies are the product of technologically induced structural transformations inside national labor markets. Increasing productivity, changing consumption patterns, and saturated demand for products from the traditional sectors of the economy are the main forces of change. It is these structural sources of risk that fuel demands for state compensation and risk sharing.

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[1] See David Cameron, "The Expansion of the Public Economy: A Comparative Analysis," *American Political Science Review* 72, no. 4 (1978); and Peter Katzenstein, *Small States in World Markets* (Ithaca, N.Y.: Cornell University Press, 1985).

[2] Dani Rodrik, "Why Do More Open Economies Have Larger Governments?" *Journal of Political Economy* 106 (October 1998).

[3] See Geoffrey Garrett, "Capital Mobility, Trade and the Domestic Politics of Economic Policy," *International Organization* 49, no. 4 (1995); and idem, *Partisan Politics in the Global Economy* (Cambridge: Cambridge University Press, 1998).

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The transformation of labor markets in recent decades is revealed in a dramatic shift in the employment structure. The two traditional and, until recently, leading sectors of employment, that is, agriculture and industry, have everywhere contracted. In the early 1960s an average of 60 percent of total employment was in agriculture and manufacturing. In the next three decades this figure dropped by nearly half (see column A, Table 1). In the United States, for example, 5 percent of the working-age population lost employment in these sectors over the last three decades, whereas in countries such as France, Germany, Sweden, and Denmark, the comparable figure is 15 percent or more. In addition to cross-national variance, the speed of the process has also varied a great deal over time. Sometimes layoffs have occurred in a slow, steady trickle; at other times they have been quick and massive, resulting in headline-grabbing factory closings.

Individuals face significant risks as a result of these shifts. Those thrown out of a job or threatened by the loss of employment may find that the skills they have acquired are not easily transferable to other parts of the economy where employment may be expanding, namely, the service sector. Even where employment is available, a job outside one of the traditional sectors often entails a significant loss in income as well as the deprivation, at least in part, of pension rights, medical insurance, and other work-related benefits. For many, indeed, loss of employment in the traditional sectors entails complete removal from the active labor force.[4] As one scholar notes, a significant part of this change in the occupational structure is due to the entry of young people into service employment and the early retirement of older workers from the traditional sectors.[5] This change is confirmed by the dramatic reduction in employment activity on the part of older workers who have in one way or another been pushed into early retirement during the last few decades.[6]

Broadly speaking, governments have responded to the transformation of the employment structure in three distinct ways. First, some

[4] There has been, however, significant cross-country variation in exposure to these risks. Those countries that were relatively early "deruralizers" were confronted with less problematic conditions, which helped them cope with structural change. Among these conditions were small entering-age cohorts, relatively low female participation in labor markets, and relatively buoyant labor markets. All of these conditions eased the problems of structural change. For a discussion of the timing of "deruralization" and its consequences, see Gøsta Esping-Andersen, *Social Foundations of Postindustrial Economies* (Oxford: Oxford University Press, 1999), 24–27.

[5] Hans-Peter Blossfeld, "Is the German Dual System a Model for a Modern Vocational Training System?" *International Journal of Comparative Sociology* 33, nos. 3–4 (1993).

[6] Martin Kohli, Martin Rein, Anne-Marie Guillemard, and Herman van Gunsteren, eds., *Time for Retirement: Comparative Studies of Early Exit from the Labor Force* (Cambridge: Cambridge University Press, 1992).

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TABLE 1
CHANGES IN THE EMPLOYMENT STRUCTURE
(CHANGES FROM 1962 THROUGH 1993 IN THE SHARES OF WORKING-AGE POPULATION).

	A *Loss in Manuf. & Agric.*	*B* *Gain in Priv. Services*	*C* *A Not Absorbed by B*	*D* *Change in Gov.t Civ. Serv.*	*E* *Change in Military*	*F* *Not Absorbed*
Australia	13.4	11.6	1.9	3.8	−0.2	−1.8
Austria	16.9	5.5	11.3	6.2	0.1	5.0
Belgium	15.2	7.7	7.5	4.2	−0.7	4.0
Canada	8.1	11.4	−3.3	6.2	−0.7	−8.8
Denmark	21.0	5.2	15.7	14.9	−0.7	1.6
Finland	27.6	4.8	22.7	8.5	−0.6	14.9
France	20.9	10.4	10.6	3.9	−1.3	8.0
Germany	15.4	7.0	8.4	4.2	−0.2	4.4
Italy	19.5	8.7	10.8	4.0	−0.6	7.4
Japan	13.6	16.0	−2.5	0.4	−0.1	−2.8
Netherlands	13.3	16.8	−3.5	1.3	−1.2	−3.5
Norway	15.8	9.3	6.5	13.9	−0.4	−7.0
Sweden	17.7	2.9	14.8	14.4	−0.4	0.8
Switzerland	17.1	20.7	−3.7	4.2	−0.1	−7.7
United Kingdom	15.6	10.4	5.4	1.1	−0.5	4.9
United States	5.3	13.3	−8.0	3.5	−1.5	−10.0
With Australia:						
Average	16.0	10.1	5.9	5.9	−0.6	0.6
St. Dev.	5.0	4.7	8.2	4.5	0.4	6.7
Without Australia:						
Average	16.2	10.0	6.2	6.1	−0.6	0.7
St. Dev.	5.1	4.8	8.5	4.6	0.4	7.0

have promoted employment in private services, often by deregulating product and labor markets and allowing greater wage dispersion. At the same time, the governments have used various forms of public insurance to compensate workers for the risks of having to find new jobs in services. The United States is the archetypal example of this strategy, but Canada, the U.K., and more recently the Netherlands share some of the same features. In the U.S., since the expansion of private sector service employment has exceeded the relative modest loss in the traditional sectors, employment rates have actually increased (as indicated by the minus signs in columns C and F of Table 1).

The second strategy is for the state to maintain extensive regulation of private services as well as a relatively compressed wage structure

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while simultaneously expanding employment in public services. Countries that have engaged heavily in this sort of strategy, most notably in Scandinavia, also have generally managed to elevate the total labor-force participation rate. On the spending side, government consumption has risen substantially, often complemented by an expansion of the state's public insurance functions in order to compensate for the risks associated with often very large employment losses in the traditional sectors (see the numbers for Denmark, Norway, and Sweden).

Finally, there are those economies where heavy regulation of labor and product markets has hampered a major expansion of private sector service employment. At the same time the public sector has not been allowed to grow to any significant extent. In combination with the large losses in the traditional sectors, this has led to a tremendous reduction in employment possibilities for those formerly active. Examples of states that have taken this route include Germany and France, and much of the welfare effort in these countries has been geared toward ensuring a relatively orderly and secure exit from the labor market, mainly through early retirement. Limiting labor-force participation in this manner is expensive, and, depending on the severity of shifts in the occupational structure, state-sponsored labor-market exit is often supplemented by an increase in the state's insurance role (as in the other countries). This response therefore creates transfer- as opposed to consumption-heavy welfare states.

The three responses clearly resonate with Esping-Andersen's typology of welfare states (liberal, social democratic, and Christian democratic),[7] and we believe that labor-market institutions and partisan politics have played an important role in shaping these responses.[8] By focusing on these major shifts in the labor-market structure and the partisan responses to them, we thus point to a causal structure that can help make sense of one of the most influential contemporary typologies of welfare states. The main focus of this paper, however, is to convince the reader that growth in both transfers and government consumption—the two main components of welfare-state spending—can largely be explained as a function of the severity of internally driven employment losses in the traditional sectors, *not* by forces in the global economy. Precisely because the underlying causal logic defines the available courses of political action, and hence helps us to account for

[7] Gøsta Esping-Andersen, *The Three Worlds of Welfare Capitalism* (Princeton: Princeton University Press, 1990).

[8] See also Torben Iversen and Anne Wren, "Equality, Employment, and Budgetary Restraint: The Trilemma of the Service Economy," *World Politics* 50 (July 1998).

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the observed variance in welfare-state forms, *getting the causal story right is important*. This is also important for the sake of understanding how the politics of the welfare state is likely to change in the future. Since the processes of globalization and deindustrialization have very different distributions in time and space, the pattern of welfare expansion (or contraction) should vary accordingly.

The remainder of this paper is organized into four sections. In the first we examine the arguments of two leading scholars, both of whom see the increasing integration of national markets into the international economy as the most powerful force affecting governments' commitments to welfare spending. We suggest that there is little empirical evidence to sustain such a position. We then introduce and outline the logic of our own argument, focusing on the consequences of the employment dislocations connected to these major shifts in the occupational labor market structure since the early 1960s. In the third section this argument is tested on data for fifteen OECD countries over a period of thirty-three years, followed by an analysis that defends our argument and findings against the charges that deindustrialization is a result of either government spending itself or globalization. We conclude with a discussion of why domestic, as opposed to international, forces have been ignored in recent research, and we point to several areas where future research could prove fruitful.

Discounting Globalization

The argument that globalization leads to welfare state expansion rests on two causal mechanisms. First, trade and capital market integration is said to expose domestic economies to greater real economic volatility, which implies higher income and employment risks for workers. Second, greater labor-market risks are hypothesized to generate political demands for expansionary spending policies that will cushion and compensate people for such risks. Rodrik focuses on the effects of trade and explains the logic in the following manner:

> More open economies have greater exposure to the risks emanating from turbulence in world markets. We can view larger government spending in such economies as performing an insulation function, insofar as the government sector is the "safe" sector (in terms of employment and purchases from the rest of the economy) relative to other activities, and especially compared to tradables.[9]

[9] Rodrik (fn. 2), 13.

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Garrett extends the trade openness argument to globalization more broadly, including growing capital market integration:

> Perhaps the most important immediate effect of globalization is to increase social dislocations and economic insecurity, as the distribution of incomes and jobs across firms and industries becomes increasingly unstable. The result is that increasing numbers of people have to spend evermore time and money trying to make their future more secure.[10]

Left governments are more responsive to popular demands for compensation than right governments, according to Garrett, and his emphasis on capital market openness is also novel. The trade openness thesis, however, has a long history in political science, going back to the seminal works of Cameron, Ruggie, and Katzenstein.[11] To our knowledge the trade argument has not been subject to any serious challenges, and it stands out as one of the important explanations for the rise of the welfare state since the Second World War. The role of capital market integration is more contentious because of the effects such integration may have on macroeconomic autonomy,[12] but it is a logical extension of the trade openness argument.

We find it surprising that the alleged linkage between international economic exposure and labor-market risks has not received more critical attention. Although it is undeniable that international market volatility increases labor-market risks, whether openness is related to risk depends on the extent to which international market volatility is greater than domestic market volatility. It is not sufficient, for example, to show that international price volatility, measured in terms of trade instability, is related to spending.[13] In addition, at least one of two conditions must obtain: (1) price volatility in international markets is greater than in domestic markets, and (2) trade concentrates more than diversifies risk.

There are no theoretical reasons to expect the first condition to hold, and trade theory does not make strong predictions about the second. Although trade concentrates risks to the extent that it leads to special-

[10] Garrett (fn. 3, 1998), 7.

[11] Cameron (fn. 1); John G. Ruggie, "International Regimes, Transactions and Change: Embedded Liberalism in the Postwar Economic Order," in Stephen D. Krasner, ed., *International Regimes* (Ithaca, N.Y.: Cornell Univerity Press, 1983); Katzenstein (fn. 1).

[12] See Fritz Scharpf, *Crisis and Choice in European Social Democracy* (Ithaca, N.Y.: Cornell University Press, 1991); and Paulette Kurzer, *Business and Banking* (Ithaca, N.Y.: Cornell University Press, 1993).

[13] See Dani Rodik, *Has Globalization Gone Too Far?* (Washington, D.C.: Institute for International Economics, 1997), chap. 3.

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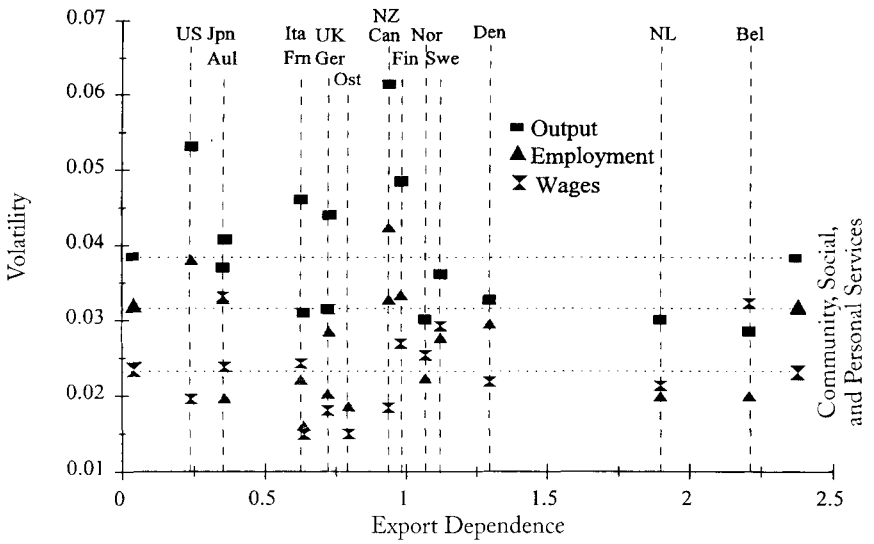

FIGURE 1
TRADE DEPENDENCE AND MANUFACTURING VOLATILITY[a]

SOURCES: OECD, *The OECD STAN Database* (1994).

[a] Export dependence is the total value of manufacturing exports divided by value added; volatility is the standard deviation in the rate of growth in manufacturing output, employment, and wages in the period 1970–93. Output data is not available for Austria; only employment data is available for New Zealand.

ization, it diversifies risks to the extent that it occurs across several national markets. Which effect dominates depends on the covariance of volatility across product and national markets. If specialization occurs within product categories that are exposed to similar cycles (complementarities) while trade occurs across national markets that are subject to different cycles, trade will actually lead to lower overall volatility. Since the bulk of trade within the OECD is intraindustry and occurs across numerous national markets, there is little a priori reason to expect that trade is associated with greater volatility. But only empirical evidence can resolve the issue.

For this purpose we have compared volatility in output, employment, and wages across the manufacturing sectors of sixteen OECD countries with very different exposures to trade (see Figure 1). Output and wages are measured in real terms, and volatility is defined as the standard deviation of annual growth rates between 1970 and 1993. This formula is

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similar to the one used by Rodrik to measure volatility in terms of trade,[14] but here we are able to explore directly whether volatility in real variables is related to trade. As a baseline for the comparison, Figure 1 shows the average volatility of a completely nontraded (but private) service sector: community, social, and personal services (indicated by the three dotted horizontal lines).[15]

Contrary to the logic of the trade openness argument, there is no relationship between the export dependence of manufacturing (measured as the value of exports divided by manufacturing value added) and any of the volatility measures. The only variable weakly related to export dependence is output volatility, but the association is in the opposite direction of the one implied by the trade openness argument. Nor is there any evidence that the traded manufacturing sector is more volatile than the average for the nontraded service sector. Finally, it is noteworthy that there is no association between the level of volatility and Katzenstein's distinction between small corporatist welfare states and large liberal (or statist) ones.

If we changed the x-axis in Figure 1 to measure capital market openness instead of trade openness, the pattern would be no clearer. It does not appear to be the case that greater openness to the international financial system increases the volatility of the domestic real economy. Moreover, even if that proved to be the case, greater exposure to speculative capital flows may well be associated with a countervailing reduction in the capacity of governments to respond to pressures for compensation.[16]

But if these findings are correct, how is it possible that previous work has found such a clear link between globalization (especially trade openness) and spending? To answer this question we would like to draw attention to some important methodological issues in that work. Katzenstein is interested primarily in the effects of the global economic crisis in small countries during the interwar years, and he never presents any systematic evidence for the more general thesis that openness breeds compensation.[17] Focusing on small and open economies, it is

[14] Rodrik (fn. 2).

[15] The government sector *is* less volatile, but it does not make sense to include it in the comparison since this sector is supposed to be growing as a consequence of high volatility in the exposed sectors.

[16] This constraint could come on both the spending and the revenue side. Thus, there is broad consensus that capital market integration has raised the price of running deficits, while others (including Rod-rik) have argued that it has made taxation of capital more difficult. The latter argument, however, is disputed by Duane Swank, who finds no evidence that business taxation has become less important for revenue generation. See Swank, "Funding the Welfare State: Globalization and the Taxation of Business in Advanced Market Economies," *Comparative Political Studies* 46 (September 1998).

[17] Katzenstein (fn. 1).

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difficult to assess whether expansion in the government's role in the economy is due to trade openness or some other features that these countries have in common. Cameron offers some cross-sectional evidence[18] but in the form of correlation coefficients or very simple regressions that fail to control for a number of factors (such as the size of the dependent population) that we now know are important. In fact, our data support Cameron's results in the sense that there is a cross-sectional association between openness and spending ($r = 0.6$), but this relationship does not hold once proper controls are included in the statistical model (as we will show). In the case of Rodrik,[19] both cross-sectional and pooled time-series evidence is presented, but the analysis includes a large number of less developed and mostly nondemocratic countries to which our argument is not necessarily applicable.[20]

The results that are most relevant for our purposes are presented by Garrett.[21] Not only does Garrett focus on the same countries that we do, he also includes capital market integration in his analysis. Furthermore, Garrett's analysis picks up both cross-national and cross-time variance and allows for a large number of controls. It is therefore of considerable interest to replicate and further examine Garrett's results, as we have done in Table 2. The first two columns of the table replicate Garrett's results using change in government transfers and in civilian government consumption as the dependent variables.[22] First, note that the results for trade openness are weak and statistically insignificant. Somewhat surprisingly, Garrett's own results do not appear to support the trade openness argument. However, the coefficient for the interaction between what Garrett calls left labor power and capital market openness is positive and statistically significant, supporting his thesis that open capital markets lead to higher spending when the political left is strong and unions are encompassing. (Left labor power is a composite index of these variables.)

[18] Cameron (fn. 1).

[19] Rodrik (fns. 2 and 13).

[20] Indeed, trade openness may be more salient for less-developed countries because trade in many of these countries, unlike trade between OECD countries, has led to heavy dependence on a few primary commodities that are subject to high international price volatility.

[21] Garrett (fn. 3).

[22] Our thanks to Geoffrey Garrett for generously providing us with the data he used in his analyses, thereby allowing us to replicate his findings. See Table 4.4 in Garrett (fn. 3, 1998), 90. Note that Garrett uses levels of spending on the left-hand side, but this formulation gives an estimate for R-squared that is uninformative since the lagged dependent variable will pick up most of the cross-national variance. Using changes in spending on the left-hand side avoids this problem while leaving the estimated coefficients the same. (In mathematical terms, we are simply subtracting the lagged dependent level variable on both sides of the equal sign, which obviously leaves the coefficients for all other variables unchanged.)

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TABLE 2
REPLICATING GARRETT'S REGRESSION RESULTS[a]

	Garrett's Results		*Our Results*	
	Transfers	*Consumption*	*Tranasfers*	*Consumption*
Lagged dependent level	−0.141***	−0.140***	−0.094***	−0.061***
	(−4.65)	(−5.49)	(−3.21)	(−3.55)
Trade openness	−0.008	−0.016*	0.005	0.004
	(−0.74)	(−1.73)	(0.50)	(0.44)
Capital openness	−0.192	−0.380**	−0.045	−0.012
	(−1.27)	(−2.45)	(−0.31)	(−0.12)
Left labor power (LLP)	0.067	0.134	0.116	0.196**
	(0.76)	(1.38)	(1.36)	(2.04)
LLP*Trade openness	0.001	0.001	−0.001	−0.001
	(0.41)	(1.00)	(−0.87)	(−0.86)
LLP*Capital openness	0.066**	0.075***	0.027	0.013
	(2.38)	(2.68)	(1.05)	(0.71)
Growth	−0.168***	−0.137***	—	—
	(−10.50)	(−11.53)		
Old population	0.135**	0.006	—	—
	(2.43)	(0.10)		
Unemployed	0.683***	0.008	—	—
	(3.67)	(0.42)		
Unexpected growth	—	—	−0.077***	−0.097***
			(−5.75)	(−12.14)
Automatic transfers	—	—	0.558***	—
			(6.93)	
Automatic consumption	—	—	—	0.970***
				(14.94)
Adjusted R-squared	0.4235	0.4835	0.4235	0.6735
Number of observations	350	350	350	350

[a] T-statistics are in parentheses. The results for period and country dummies are not shown.
* Significance level: < 0.10
** Significance level: < 0.05
*** Significance level: < 0.01

The results, however, turn out to be highly sensitive to the precise specification of the control variables. One of these controls is GDP growth, which Garrett explains with reference to an article by Roubini and Sachs.[23] In that article the authors argue that governments make

[23] Garrett (fn. 3, 1998), 80; Nouriel Roubini and Jeffrey D. Sachs, "Political and Economic Determinants of Budget Deficits in the Industrial Democracies," *European Economic Review* 33, no. 5 (1998).

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spending decisions based on economic forecasts which rely on actual growth in the recent past. If growth turns out to be unexpectedly high, spending as a proportion of GDP will be smaller than anticipated, while spending will be higher if GDP growth is unexpectedly low.[24] They therefore define an "unexpected growth" variable, which is the difference between actual growth in a given year and average growth in the previous three years. This variable is obviously correlated with GDP growth, but it is not identical, and we have consequently substituted Roubini and Sachs's variable for Garrett's simple GDP growth variable in columns 3 and 4.

In addition, we made some refinements to the variables intended to remove nondiscretionary components of spending. In the case of transfers the relevant controls are the rate of unemployment and the size of the old-age population. These variables can be improved by taking into account the replacement rates for nonemployment that vary across time and countries. Therefore, to measure nondiscretionary transfers more accurately, we multiply the change in the size of the dependent population (that is, the proportion of unemployed and old people) by the replacement rates at any given point in time. In turn, average replacement rates can be approximated as the share of transfers in GDP relative to the share of the dependent population in the total population.[25] This composite variable is used in column 3 in place of the unemployment rate and the old-population rate.

In the case of government consumption, the number of unemployed and old people is irrelevant (as Garrett's results clearly show), but Garrett does not take into account a different nondiscretionary effect. Because costs in public services (especially wage costs) tend to increase at the same rate as in the rest of the economy, while productivity does not, a constant level of provision will cause prices of government services to rise faster than in the economy as a whole. This nondiscretionary component of government consumption can be removed by another measure, called automatic consumption, which is the share of government consumption in GDP multiplied by the rate of growth in the price deflator for government services divided by the rate of growth in the price deflator for the entire GDP.[26]

From the rise in explained variance (see Table 2), the importance of relative price changes for government consumption becomes clear.

[24] See Thomas Cusack, "Partisan Politics and Public Finance: Changes in Public Spending in the Industrialized Democracies, 1955–1989," *Public Choice* 91 (June 1997); and idem, "Partisan Politics and Fiscal Policy," *Comparative Political Studies* 32 (January 1999).

[25] Ibid.

[26] Cusack (fn. 24, 1997).

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More importantly, the effects of capital market openness completely disappear once these refined controls are included. This is the case whether consumption or transfers are examined. With respect to trade openness, one can see that the parameter on this variable is insignificant as before, but the sign on the interaction term is now actually in the wrong direction. In short, Garrett's data does not support the existence of a relationship between globalization and welfare state spending once more refined control variables are used. The only result that holds up is that left-labor power has a significant expansionary effect on government consumption—a finding that is echoed in the more extensive analysis presented below and by numerous other studies.[27]

We would like to underscore that these results do not undermine Garrett's main conclusion that globalization is compatible with a large welfare state. In fact, we agree with most of Garrett's critique of the globalization literature's predictions of broad-based retrenchment. But we also do not believe that globalization has been much of a factor in the postwar expansion of the welfare state. This leaves a conspicuous gap in the general understanding of the growth of the welfare state over the past four decades. Traditional explanations that emphasize the role of the industrial working class run up against the inescapable fact that spending has skyrocketed in many countries precisely during a time when the industrial working class has been in steep decline. This does not mean that partisanship is unimportant for the form that this expansion has taken, as we explain below, but it does mean that, to understand the driving force behind the expansion, it is necessary to look beyond standard class-power explanations.

Deindustrialization and the Labor-Market Risk Structure

Like Garrett and Rodrik we believe that exposure to risk in the labor market is a powerful determinant of peoples' preferences for state protection and public risk sharing, and we argue that the main sources of risk are to be found in the interaction of sector-specific skills and domestic economic processes. In particular, we suggest that the labor-market dislocations associated with major shifts in the sectoral-occupational structure have been a driving force behind the expansion

[27] For recent examples see Cusack (fn. 24); Alexander Hicks and Duane Swank, "Politics, Institutions, and Welfare Spending in Industrialized Democracies, 1960–82," *American Political Science Review* 86 (September 1992); and Evelyn Huber, Charles Ragin, and John Stephens, "Social Democracy, Christian Democracy, Constitutional Structure and the Welfare State," *American Journal of Sociology* 99, no 3 (1993).

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of the welfare state since the early 1960s. To get a sense of the numbers, in 1962 about 60 percent of the labor force in the OECD area was employed in agriculture or industry; thirty-three years later this figure had dropped to about 30 percent. As we document below, this massive sectoral shift is the outgrowth of deep forces of technological change that have coincided with progressive market saturation and shifting patterns of demand—structural-technological conditions that also characterized the industrial revolution. Given the work of Esping-Andersen,[28] Korpi,[29] Stephens,[30] and others about the relationship between the rise of industry and the early development of the welfare state, one would expect such a massive transformation of the occupational structure to be of great importance in the demand for and supply of welfare state programs.

The importance of changes in the occupational structure depends on the transferability of skills and social benefits. Transferable skills protect against market vagaries by making individuals less dependent on a single employer or on employers in a particular branch of the economy. Labor-market risks are therefore generated across the interfaces between economic sectors requiring very different types of skills. This logic is reinforced when we consider that privately provided social benefits such as health insurance and pensions also tend to be constrained by the transferability of skills. Thus, when skills are firm-specific, employers have an incentive to provide nontransferable company benefits, both as a tool of control over its workforce and as an incentive for their employees to acquire additional firm-specific skills.[31] Correspondingly, if skills are industrywide, employers in that industry have a rationale for providing benefits that are transferable across firms, but only within the industry. Although the latter depends on the ability of employers to collude in the provision of both skills and benefits, the point is that the transferability of benefits will not exceed the transferability of skills in the absence of state intervention.

The approximate correspondence between the scope of employer-sponsored insurance and the transferability of skills tells us a great deal about the sources of demand for welfare state expansion. Once a worker

[28] Gøsta Esping-Andersen, *Markets against Politics: The Social Democratic Road to Power* (Princeton: Princeton University Press, 1985); idem (fn. 7).

[29] Walter Korpi, *The Working Class in Welfare Capitalism: Work, Unions and Politics in Sweden* (London: Routledge and Kegan Paul, 1978); idem, *The Democratic Class Struggle* (London: Routledge and Kegan Paul, 1983).

[30] John D. Stephens, *The Transition from Capitalism to Socialism* (London: Macmillan, 1979).

[31] See the pathbreaking study by Isabela Mares on the role of employees in social policy formation. Mares, "Negotiated Risks: Employers' Role in Social Policy Development" (Ph.D. diss., Harvard University, 1998).

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is permanently dismissed from a firm or occupation within a sector, and therefore has to either transgress a skill boundary or remain nonemployed, both skills and benefits will be forfeited or downgraded. In some cases, then, workers are left outside employment with no or few means of support; in other cases, workers find new jobs at substantially reduced wages and benefits levels. Thus, workers can protect themselves against the risks of major shifts in the economic and occupational structure only through the mediation of the state. Such protection comes in the form of state-guaranteed health and old-age insurance (which makes it possible to move across sectoral interfaces without losing benefits) as well as through early retirement and certain forms of disability insurance, which facilitate a relatively painless exit from the labor market (and therefore makes it possible not to have to move across the skill interfaces). When skills and benefits do not travel well, while large numbers of people face the risks of having to make such "travels," we would therefore expect demand for state-sponsored compensation and risk sharing to be high.

Such demands are not necessarily opposed by employers, as commonly assumed in the welfare state literature, and our logic highlights one of the most important reasons why. Without assurances from the state, workers will be less likely to make risky investments in nontransferable skills—skills that are very valuable to employers. Especially with the transition to more knowledge-intensive forms of production, firms that rely on firm- and industry-specific skills share with their employees an interest in strengthening the aspects of the welfare state that reduce the riskiness for workers of making investments in specific skills. Though clearly at odds with the standard perception that business always opposes social spending, the argument is consistent with an emerging new body of scholarship that documents the supportive and often proactive role of some groups of employers in developing and shaping the modern welfare state.[32]

Like the distinction between agriculture and industry in the latter half of the previous century, the distinction between manufacturing and services represents one of the most important economic interfaces affecting the transferability of skills in the latter half of the twentieth century. Whereas skills within agriculture, manufacturing, or services are typically transferable to some degree, most skills acquired in either manufacturing or in agriculture travel very poorly to services occupa-

[32] See, for example, ibid; Cathie Jo Martin, "Nature or Nurture? Sources of Firm Preference for National Health Reform," *American Political Science Review* 89 (December 1995); and Peter Swenson, "Arranged Alliance: Business Interests in the New Deal," *Politics and Society* 25, no. 1 (1997).

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tions. Even low-skilled blue-color workers find it exceedingly hard to adjust to similarly low-skilled service sector jobs because they lack something that is vaguely referred to as social skills. In addition, as noted above, the shift in the distribution of employment between these sectors has been quite dramatic since the beginning of the 1960s. If our theoretical argument is correct, therefore, we should find at least some evidence that deindustrialization has expanded the welfare state since the early 1960s. This does not imply that no skills are transferable from industry to services or that other skill interfaces in the economy are irrelevant. Our only claim is that deindustrialization picks up one salient empirical manifestation of our theoretical logic. We are of course quite happy to concede that the use of deindustrialization as a proxy for the underlying theoretical variable—the risk of moving across skill boundaries—only establishes a lower bound for the explanatory power of our general argument.

Considering this obvious link between labor force transformations and welfare state spending, it is remarkable how little attention deindustrialization has been accorded in the study of welfare state dynamics. Not a single large-N cross-national study of the welfare state has to our knowledge focused on deindustrialization as a driving force or even included it as a control variable. Wilensky,[33] Flora and Alber,[34] and others have pointed to the importance of economic transformations, industrialization in particular, to explain the rise of the welfare state. However, the emphases in their explanations—problems associated with industrialization such as dangerous working conditions and income security for those denied access to employment[35] as well as demographic structural changes induced by the growth in overall economic well-being[36]—are very different from ours and not clearly applicable to the phenomenon of deindustrialization that we are interested in.[37]

Perhaps this omission in the literature is due to a misconception that deindustrialization is fairly uniform across countries and time and

[33] Harold L. Wilensky, *The Welfare State and Equality* (Berkeley: University of California Press, 1975).

[34] Peter Flora and Jens Alber, "Modernization, Democratization, and the Development of Welfare States in Europe," in Flora and Arnold Heidenheimer, eds., *The Development of Welfare States in Europe and America* (London: Transaction Books, 1981).

[35] Ibid., 41.

[36] See Wilensky (fn. 33), 47.

[37] There are passages in Harold L. Wilensky and Charles N. Lebaux's *Industrial Society and Social Welfare* that concern the problem of relocating and retraining workers made redundant in the process of industrialization in the U.S. This logic is clearly in line with our argument. We thank an anonymous reader for pointing this out. Wilensky and Lebaux. *Industrial Society and Social Welfare: The Impact of Industrialization on the Supply and Organization of Social Welfare Services in the United States* (New York: Russell Sage Foundation, 1958).

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therefore cannot explain cross-national and temporal variance in the speed of welfare state expansion. In fact, however, deindustrialization varies greatly in both time and space. For example, in an early industrializing country like the United States, industrial employment as a percentage of the adult population never reached the same levels as in a late industrializer like Sweden—22 versus 31 percent at their peaks. The decline was correspondingly much slower and modest in the U.S., falling by 3 percent between 1962 and 1993 compared to 13 percent in Sweden. In general, the amplitude of the swings in the sectoral employment structure is much greater in late than in early industrializers, which accounts for most of the variance in the speed of deindustrialization. As we show below, the best predictor of deindustrialization is simply previous levels of industrialization.

Both the magnitudes of the sectoral shifts in employment and the cross-national differences are magnified by the decline of agriculture. Although we usually associate agricultural decline with the rise of industry, the two processes started to move in phase in the early to mid-1960s, particularly in countries that industrialized late. Agricultural decline is due to the same forces of structural-technological change, which is explored below. Hence, when we talk about deindustrialization in the following, we have in mind this secular, long-term, and structurally driven process of labor shedding in *both* agriculture and industry beginning in the early 1960s.

While we maintain that deindustrialization is a crucial (and neglected) source of welfare state expansion, we are not implying that political and institutional factors are unimportant. As Garrett emphasizes in his work, the welfare state is a mechanism for redistribution as well as risk sharing. We would therefore expect partisan governments and organized interests to shape social policies in order to benefit the distributive interests of their own constituencies. As argued well by Garrett, where unions are strong and centrally organized and where left governments have been dominant, the welfare state can be expected to assume a more redistributive form.[38] Likewise, redistribution is affected by the location of the median voter insofar as political parties adopt policies that will appeal to the median voter.[39] The lower the income of

[38] Garrett (fn. 3).

[39] The attraction of the median voter depends on the electoral system. In two-party systems the mechanism is vote maximization, which leads to centrist appeals. See Anthony Downs, *An Economic Theory of Democracy* (New York: Harper and Row, 1957), chaps. 7–8; and Gary W. Cox, "Centripetal and Centrifugal Incentives in Electoral Systems," *American Journal of Political Science* 34, no. 4 (1990). In multiparty systems the mechanism is office maximization through which governing coalitions come to recognize the importance of appealing to the median voter. See Michael Laver and Norman

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the median voter and the more exposed to risk, the greater the pressure for redistributive policies.[40] Since low-income workers in tenuous labor-market positions are less likely to vote than better educated and higher-income people,[41] an indirect measure of the median voter location is the level of participation in national elections.

The explanatory salience of these political variables depends on the extent to which we look at spending categories that have a redistributive effect. Aggregate levels of transfers are not necessarily higher under left than under right governments insofar as such transfers can be used to address labor-market risks without affecting income or status differentials.[42] By contrast, government service provision is inherently redistributive because it offers people equal access to services, such as education, health care, and housing, which are paid for through taxation. In addition, egalitarianism and public sector expansion are causally related because earnings compression undermines the growth of low-productivity and price-sensitive private service sector jobs, thereby putting pressure on the government to provide "compensating" jobs in the public sector.[43] So while deindustrialization everywhere propels the growth of welfare state spending, whether in the form of government transfers or consumption, we expect the distributive aspects of the rising service economy and the private-public sector mix of employment to vary according to political parameters.

Findings

We use an error correction model of the type introduced in Table 2, with changes in government transfers and civilian government consumption as the dependent variables. The model has the following form:

$$\Delta Y_{i,t} = \alpha + \beta_1 \cdot Y_{i,t-1} + \Sigma\beta^j \cdot X^j_{i,t-1} + \Sigma\beta^j_\Delta \cdot \Delta X^j_{i,t} + \varepsilon_t,$$

where Y is a spending variable and X is an independent variable. The subscripts i and t refer to the particular country and time period re-

Schofield, *Multiparty Government: The Politics of Coalition in Europe* (Oxford: Oxford University Press, 1991).

[40] Alan Meltzer, and Scott Richard, "A Rational Theory of the Size of the Government," *Journal of Political Economy* 8, no. 9 (1981). See also Hicks and Swank (fn. 27).

[41] Arend Lijphart, "Unequal Participation: Democracy's Unresolved Dilemma—Presidential Address," *American Political Science Review* 91, no. 1 (1997).

[42] Esping-Andersen (fn. 7).

[43] See Gøsta Esping-Andersen, *Changing Classes: Stratification and Mobility in Postindustrial Societies* (London: Sage, 1993); idem, *Social Foundations of Postindustrial Societies* (Oxford: Oxford University Press, 1999); Iversen and Wren (fn. 8); and Andrew Glyn, "Low Pay and the Volume of Work" (Manuscript, Corpus Christi College, Oxford University, 1997).

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spectively, while the superscript *j* refers to the particular independent variable. Δ is the first difference operator.

This model has a number of useful properties, and it is consistent with recommendations on specifications that are capable of capturing both long- and short-term dynamics in a pooled time-series-cross-section context.[44] First, the parameter for the lagged dependent level variable (β_1) provides an easy check on equilibrium properties. β_1 should be between −1 and 0 to ensure that the incremental effects of a shock to any exogenous variable are progressively reduced over time, causing spending to converge to a long-term equilibrium. For readers more familiar with models that use the *level* of spending on the left-hand side, the current model can be reformulated into such a model by simply adding $Y_{i,\,t-1}$ on both sides of the equal sign. This yields $Y_{t,i} = \alpha + (1 + \beta_1) \cdot Y_{i,t-1} + \ldots$, where $(1 + \beta_1)$ is the new parameter for the lagged dependent level variable. There is a small advantage to using the error correction formulation, however, because the model yields estimates of R^2 that are more informative of the variance explained by the independent variables of interest.[45] Otherwise the choice to use either levels or first differences does not affect the results.

The other useful feature of the present model is that it enables us to separate out permanent and transitory effects of any independent variable. Although not intuitively obvious, it can be shown that the parameter for a lagged independent *level* variable, $X_{t-1,}$ is a measure of the permanent (or lasting) effect of a one-off change in that variable, while the parameter for a *change* variable, ΔX_t is a measure of the transitory (or passing) effect of a one-off change in that variable.[46] The long-term permanent effect of an independent variable can be calculated by dividing the parameter for the lagged level of that variable by minus the parameter for the lagged dependent level variable: $\beta^j/-\beta_1$ (assuming that β_1 is between 0 and −1). If a variable exhibits *only* transitory effects, that is, if only the parameter for its first difference is different from zero, spending will eventually revert back to its original level unless the independent variable changes continuously (assuming again that β_1 is between 0 and −1). Since all the theoretical variables are defined as

[44] See Nathaniel Beck and Jonathan N. Katz, "Nuisance vs. Substance: Specifying and Estimating Time-Series-Cross-Section Models," in John R. Freeman, ed., *Political Analysis*, vol. 6 (Ann Arbor: University of Michigan 1996), 11.

[45] The reason is that in the model using levels of spending on the left-hand side, much of the variance will be accounted for by the lagged dependent variable, showing simply that current spending depends on past spending.

[46] See Nathaniel Beck, "Comparing Dynamic Specifications: The Case of Presidential Approval," in James Stimson, ed., *Political Analysis*, vol. 2 (Ann Arbor: University of Michigan Press, 1992).

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proportions (either of GDP or of the working-age population), they cannot grow (or fall) without limit and will therefore have no lasting effects on spending unless the parameters for the their lagged levels are nonzero.[47] Hence, the parameters for the change variables are of interest only if we care about the specific time dynamics of an independent variable. To keep the results simple, we have therefore only included first differences for those independent variables that are of particular theoretical interest.

We use fairly much the same set of explanatory variables for both transfer spending and civilian government consumption outlays. The exact variable definitions and data sources are summarized in the Appendix. The only difference between the two specifications is the "autonomous" spending term in each equation. In the equation for transfers, this item is based on the prevailing replacement rates of the program (at time t−1) times the first difference in the size of the clientele for such programs. In the equation for government consumption, the autonomous spending term is a function of the prevailing level of spending (at time t−1) times the rate of change in the relative prices confronting government. As discussed above, in both instances the argument is that there are nondiscretionary elements to spending that need to be eliminated in any well-specified model.[48]

In addition to the lagged level of the spending component, there are four sets of variables in each specification. First, there is a set of variables meant to detect whether international or domestic economic sources are driving spending. On the international side, we have included measures of trade openness as well as capital mobility. On the domestic side, we have introduced measures for deindustrialization and for a variety of political variables such as the level of electoral turnout, the left-right partisan composition of the government, and a measure of the relative strength of labor within the industrial relations system. The remaining control variables have already been introduced in the discussion of Garrett's results.

Deindustrialization is defined as 100 minus the sum of manufacturing and agricultural employment as a percentage of the working-age

[47] This does not *have* to be the case. One of the control variables, unexpected GDP growth, can in principal rise indefinitely.

[48] The basic results we report below for the deindustrialization and globalization variables are robust to a large number of alternative model specifications. Thus, we have tried to group the data into time intervals using different periodizations; we have run the regression with and without the political variables, with and without the change terms; and we have tried to exclude one country at a time. In all cases the results for deindustrialization are strong and statistically significant, whereas for the globalization variables, they are weak and statistically insignificant, with the exceptions noted in the text.

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population. The base of 100 is somewhat arbitrary. For example, the peak of employment in agriculture and manufacturing, a number that varies across countries, could have been used as the base instead. However, the statistical analysis is insensitive to the choice of base due to the inclusion of a full set of country dummies.[49] If each country has a unique base, it simply alters the nationally specific intercepts that can take on any value. Also, it should be emphasized that because deindustrialization is defined as a proportion of the working-age population it is not the case that public employment, which is closely related to government consumption, will alter the denominator. The only way that government consumption, or any other form of government spending, can affect the deindustrialization measure is if spending is causally related to the number of people employed in agriculture or industry—a possibility we will consider in the next section.

The equations have been estimated using a pooled data set with fifteen countries and a temporal domain ranging from 1961 up to and including 1993, a period of thirty-three years. Tests for heteroskedasticity in both pooled regressions suggested the need to correct for this problem and so we employed Beck and Katz's method for deriving panel corrected standard errors.[50] The results for two simple additive models, one for each category of spending, are presented in Table 3. Separate runs using robust regression techniques (not shown) yield almost identical results, so our findings are not driven by outliers.[51]

First, note that none of the globalization variables registers a statistically significant permanent impact on government transfers, only a small transitory effect of trade openness. For consumption, trade and capital market openness both exhibit small significant effects, but for capital mobility the effect is entirely transitory, while for trade it goes in the opposite direction of that predicted by the openness argument. It is conceivable that the negative effect for trade reflects its differential welfare effects. Thus, while growing exposure to competition from low-wage countries raises the uncertainty for those already at high risk,[52]

[49] An F-test indicates that the country dummies belong in the model.

[50] Nathaniel Beck and Jonathan N. Katz, "What to Do (and Not to Do) with Time-Series-Cross-Section Data," *American Political Science Review* 89, no. 3 (1995).

[51] Specifically, we used Roy E. Welch's "bounded-influence technique," which weights individual cases if they exceed a size-adjusted cut-off point. Welch, "Regression Sensitivity Analysis and Bounded-Influence Estimation," in Jan Kmenta and James B. Ramsey, eds., *Evaluation of Econometric Models* (New York: Academic Press, 1980), 164–66. See also J. Fox, *Regression Diagnostics* (London: Sage Publications 1991), 31.

[52] Andrian Wood, *North-South Trade, Employment and Inequality: Changing Fortunes in a Skill-Driven World* (Oxford: Oxford University Press, 1994); Edward E. Leamer, *Sources of International*

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TABLE 3
REGRESSION RESULTS FOR GOVERNMENT SPENDING[a]

		Transfers	*Consumption*
	Lagged spending level (Y_{t-1})	−0.067***	−0.051***
		(−3.17)	(−3.78)
Globalization variables	Trade openness	−0.005	−0.004*
		(−1.21)	(−1.72)
	Δ Trade openness	0.018	−0.005
		(2.09)**	(−0.99)
	Capital openness	0.010	−0.007
		(0.35)	(−0.39)
	Δ Capital openness	0.016	−0.069**
		(0.29)	(−2.07)
Deindustrialization variables	Deindustrialization	0.044***	0.031***
		(3.10)	(3.18)
	Δ Deindustrialization	0.142***	0.090***
		(3.69)	(4.08)
Political variables	Left government CoG	−0.062	0.090***
		(−1.24)	(2.67)
	Δ Left government CoG	0.041	0.049
		(0.62)	(1.19)
	Electoral participation	−0.005	0.012***
		(−0.69)	(2.67)
	Strength of labor	0.078	0.898***
		(0.09)	(2.88)
Controls	Unexpected growth	−0.077***	−0.092***
		(6.43)	(14.59)
	Automatic transfers	0.845***	
		(9.53)	
	Automatic consumption		0.971***
			(15.87)
	Adjusted R-squared	0.47	0.63
	Number of observations	495	495

[a] T-scores are in parentheses. The results for country dummies are not shown.
* Significance level: <0.10
** Significance level: <0.05
*** Significance level: <0.01

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trade may well improve welfare for all others.[53] Whatever the explanation, the magnitude of the effect is small. Thus, for each percentage point that the foreign sector grows, the long-term equilibrium level of civilian government consumption declines by only 0.07 percent.

Compare these results with those for deindustrialization. For each percent decline in employment in the traditional sectors, the long-term target equilibrium for social transfer spending increases by approximately 0.4 percent. The corresponding effect for government consumption is 0.6 percent, while the short-term impact is the elevation of the actual spending level by 1 percent for every percent decrease in employment in the traditional sectors. In other words, a standard deviation change in deindustrialization is associated with roughly one-half of a standard deviation change in spending, which implies that about half of the variance in spending is explained by the deindustrialization variable. All effects of deindustrialization are statistically significant at a 0.01 level or better. From these results it seems justified to conclude that the effects of the domestic economic variables carry far greater weight than globalization in shaping government spending.[54]

Another feature of the findings deserves emphasis: the effect of deindustrialization persists over time. Apparently spending gets locked in by organizational and institutional factors that are exogenous to our model. As argued by Pierson, spending itself creates political clienteles that will press for further spending and resist attempts at retrenchment.[55] Hence, even though the process of deindustrialization is the causal agent in the expansion of the welfare state, the disappearance of this causal agent will not necessarily lead to retrenchment but will "merely" retard further expansion. However, the character of the political game over welfare policies is likely to change when compromises

Comparative Advantage: Theory and Evidence (Cambridge: MIT Press, 1984); idem, "Trade Economists View of U.S. Wages and 'Globalization'" (Paper presented at the Political Economy of European Integration Study Group Meeting, University of California, Berkeley, January 1996).

[53] Rodrik (fn. 2), chap. 4.

[54] We tested whether the effects of employment losses in agriculture differ from those in manufacturing by breaking the deindustrialization variable into two component variables: one variable defined as 100 minus manufacturing employment as a percent of the working-age population, and another defined as 100 minus agricultural employment as a percent of the working-age population. The results for both variables are similar to those for the deindustrialization variable, but when both variables are entered simultaneously, the manufacturing variable has a somewhat stronger effect (0.045 versus 0.035 for transfers, and 0.035 versus 0.022 for consumption). One reviewer suggested that a possible reason for this pattern can be found in social mobility studies, which show that a greater decline in agriculture occurs through intergenerational mobility than in manufacturing.

[55] Paul Pierson, *Dismantling the Welfare State: Reagan, Thatcher and the Politics of Retrenchment* (New York: Cambridge University Press, 1994); idem, "The New Politics of the Welfare State," *World Politics* 48 (January 1996).

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involving overall expansion are no longer feasible—a conjecture that deserves further exploration, considering that the process of deindustrialization is coming to a halt in many countries.

None of the political terms register any impact on transfers. As discussed previously, the level of transfer payments is not necessarily a contentious partisan issue, unlike the distributive composition of such payments. As Esping-Andersen notes, "There is no reason to expect that expenditure commitments, as such, should be related to left-party power."[56] Right as well as left governments, exposed to the pressures of democratic politics, recognize the need to address the risks that people encounter in the labor market; these risks are largely captured by the deindustrialization variable. Where they obviously differ is in terms of whose interests in the electorate are accorded more or less attention, a distributive issue to which the aggregate level of transfers does not speak.

In this respect the logic of government consumption is very different because public provision of services directly reduces inequalities in peoples' access to basic services such as education and health care and because public employment is used by left governments to support egalitarian wage policies.[57] Unsurprisingly, therefore, all of the political variables turn out to affect civilian government consumption in the predicted direction. Thus each percentage increase in the electoral participation rate raises the target level of spending by about 0.15 percent. Likewise, a typical left government spends about 2 percent more than a typical right government if we look at the long run.[58] The strength of labor in the industrial relations system also has an upward effect on spending, as expected.

These results, however, disguise a richer causal story that cannot be captured by simple additive models like those presented in Table 3. As argued by Garrett and others, the effects of forces that create labor-market risks are conditional on political and institutional factors, and our argument implies several causal pathways for the relationship between deindustrialization and spending. In order to pinpoint these mechanisms and to bring out the interaction effects that are implied by the theoretical argument, we have conducted a causal path analysis. The results from this analysis are summarized in Figure 2.

The effect of deindustrialization runs along two different paths. First, deindustrialization raises the generosity of transfer payments as

[56] Esping-Andersen (fn. 7), 115.

[57] Ibid.; Iversen and Wren (fn. 8).

[58] A typical left government is defined here as one that is 1 standard deviation to the left of the mean on the partisan government variable. A typical right government is defined similarly.

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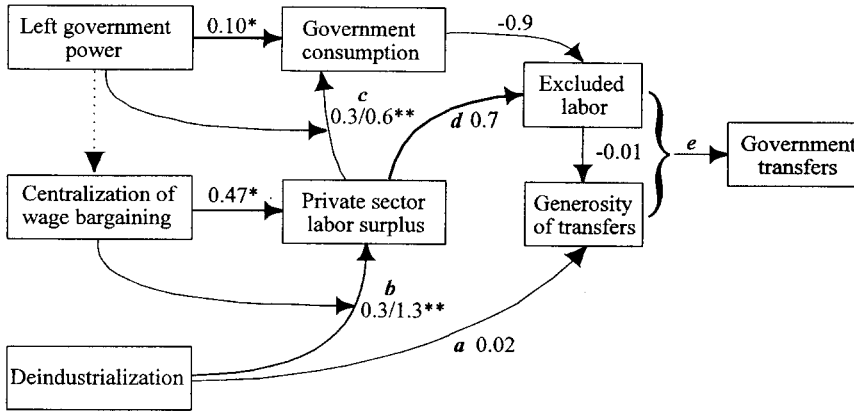

FIGURE 2
THE CAUSAL MECHANISMS LINKING DEINDUSTRIALIZATION TO SPENDING[a]

[a] All parameters are long-term, permanent effects; all are significant at a .05 level or better. Variables are defined in the text and in the appendix.

KEY:

a: Deindustrialization creates electoral pressures to ensure against labor-market risks (higher "generosity of transfers").

b: Deindustrialization leads to redundancies when private service sector employment growth is constrained (which is greater when wage bargaining is centralized).

c: Employment problems generate electoral pressures to expand government services (which are accommodated primarily under left governments).

d: Redundant labor that is not being employed in either private or public services will increase the number of people reliant on transfers ("excluded labor").

e: Government transfers are equal to the product of "excluded labor" and "generosity of transfers."

*: Long-term effect when deindustrialization (alternatively: private sector labor surplus) is at its mean value; **: effect of deindustrialization (alternatively: private sector labor surplus) when the conditioning variable is 1 standard deviation below or above its mean.

governments respond to electoral pressures for insurance against labor-market risks (path *a*). Generosity is measured here as the ratio of transfers to GDP over the ratio of the nonworking to the total population. Thus, if transfers as a proportion of the total size of the economy rise faster than the share of the nonworking population, generosity will increase. As before, we use a pooled error correction model with changes in generosity on the left-hand side, and the lag of the level of generosity plus all the variables in the second column of Table 3 on the right-hand side. The coefficient next to the causal arrow measures the permanent long-term effect of deindustrialization. In substantive

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terms, the estimated coefficient suggests that a 1 percent loss of employment in the traditional sectors will raise the level of generosity by a similar amount, adjusting for all indirect effects. In turn, higher generosity obviously implies higher government transfers, so deindustrialization is directly related to spending via generosity.

The second causal path goes through the employment effects of deindustrialization, which are conditioned by labor-market institutions and partisan politics. Insofar as redundant labor in the traditional sectors are not being picked up by new employment in private services, (path *b*) governments are likely to face electoral pressures to create employment by expanding public provision of services (path *c*). This effect, however, is conditioned by two political-institutional variables. First, we know from past studies that the capacity of the private service sector to generate employment is negatively related to wage compression.[59] The likely reason for this negative relationship is that productivity grows at a much slower rate in most services than in most manufacturing. Hence, in labor-intensive services, which include many personal and social services, a tightly coupled and compressed wage structure will result in rising relative prices and therefore in a slower rate of new job creation. Because centralized wage bargaining is closely related to wage compression,[60] this phenomenon is observed primarily in northern Europe where bargaining is highly centralized. And it shows up clearly in our results as an interaction effect between deindustrialization and centralization of bargaining.

More specifically, in liberal market economies with decentralized bargaining, such as Canada or the United States, most or all employment losses in the traditional sectors are picked up by growth in private service employment. Surplus labor in the private sector, measured as the difference between deindustrailization and changes in private service sector employment, is consequently small or absent. By contrast, when bargaining is centralized, as in Germany or Sweden, deindustrialization produces large numbers of workers who cannot find employment in private services. In terms of our regression analysis, which includes controls for labor-force participation rates and economic

[59] See Eileen Appelbaum and Ronald Schettkat, "Employment and Productivity in Industrialized Countries," *International Labor Review* 134, nos. 4–5 (1995); and Iversen and Wren (fn. 8).

[60] Robert Rowthorn, "Corporatism and Labour Market Performance," in Jukka Pekkarinen, Matti Pohjola, and Rowthorn, eds., *Social Corporatism* (Oxford: Clarendon Press, 1992); Michael Wallerstein, "Wage-Setting Institutions and Pay Inequality in Advanced Industrial Societies," *American Journal of Political Science* 43 (July 1999); David Rueda and Jonas Pontusson, "Wage Inequality and Varieties of Capitalism" (Working paper, Institute for European Studies, Cornell University, 1998).

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growth, when centralization is one standard deviation below the mean, a 1 percent drop in manufacturing employment results in a 0.3 percent increase in the private sector employment surplus. When centralization is one standard deviation above the mean, this effect is about four times greater.[61]

There is a close relationship between left partisan control over government power and centralization of wage bargaining (r = 0.8). Although this relationship has emerged only through a complex historical process without a clear-cut causal order, it is among the liberal market economies—those dominated by flexible labor markets and liberal governments—where governments are faced with the fewest problems of private sector labor redundancies. Instead, these countries "pay" for deindustrialization in the form of higher wage inequality, partly cushioned by the increased generosity of transfer payments (path *a*). Other countries have dealt with the employment pressures from deindustrialization in ways that also depend on the partisan orientation of the government. Specifically, wherever the left holds strong positions in government, service employment is expanded by increasing the direct provision of government services, that is, through a rise in government consumption (path *c*). In substantive terms, when left partisanship is one standard deviation above the mean, a one standard deviation increase in the private sector labor surplus is associated with a commensurable increase in government consumption. When considering countries with centralized bargaining systems, right governments (of a mostly Christian democratic bent) shy away from expanding public service production. The increase in consumption in these cases is correspondingly less than half the increase in the labor surplus of the private sector.

Finally, when redundant labor is not absorbed into public service employment, the private sector labor surplus will register in the form of early retirees, disability pensioners, and unemployed workers (labeled *excluded labor* in Figure 2) who have to be cared for through a variety of cash benefits arrangements (path *d*). This leads to an increase in government transfers, the size of which depends on the generosity of these transfers ("transfers" is simply "generosity" times "excluded labor"). The increase is not directly proportional to the increase in the excluded labor force because the latter has a dilution effect on the generosity of transfers, presumably because governments will seek to limit the bud-

[61] Both figures are slightly exaggerated because there are small negative *indirect* effects of deindustrialization (through growth and other variables) that reduce the net impact of deindustrialization. Yet these indirect effects do not affect the *gap* in the effect of deindustrialization between countries with centralized and decentralized bargaining structures, which is what is of interest here.

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getary pressures by cutting other welfare programs. Still, the net effect is a significant increase in total government transfers.

In combination, the results from these regression analyses strongly support the deindustrialization argument. Thus, as deindustrialization increases, both government transfers and government consumption rise, but the latter effect is particularly strong when wage bargaining is centralized and when governments are dominated by left parties. Under right governments, most of the effect comes through increases in transfers. The reason is that right governments will not compensate for private sector labor redundancies through public service production, using instead transfer schemes, such as early retirement, to facilitate labor-market exit. Since centralized wage bargaining reduces the absorptive capacity of workers who are made redundant in the traditional sectors, the effect on transfers is particularly strong when bargaining is centralized.

The Sources of Deindustrialization

Our results strongly suggest that deindustrialization, not trade or capital market openness, is the driving force behind the expansion of government spending on both transfers and services. Nevertheless, it could be objected that deindustrialization may itself be a consequence of trade and financial openness or that it is caused by, not causing, government spending. Even though either one of these possibilities is interesting in its own right, both would obviously significantly alter the picture we have presented of the relationship between deindustrialization and spending. In order to complete our argument, we therefore have to show that deindustrialization is largely driven by domestic factors other than spending itself.

Economists are divided on the question of whether trade causes employment losses in the traditional sectors. On one side of the debate, reflecting not only a particular economic theory but also a generally popular view (the "giant sucking sound"), is the idea that the sources of deindustrilization in the West during recent decades lay squarely in the competitive pressures emanating from Third World producers.[62] From this perspective, changes in the North-South trade have been estimated to account on average for 50 percent of the reduction in manufacturing that occurred between 1970 and 1990.[63] In addition, it can be argued

[62] See, for example, Wood (fn. 52); Steven S. Saeger, "Globalization and Economic Structure in the OECD" (Ph.D. diss., Harvard University, 1996); and idem, "Globalization and Deindustrialization: Myth and Reality in the OECD," *Weltwirtschaftliches Archiv* 133, no. 4 (1997).

[63] Saeger (fn. 62, 1997), 604.

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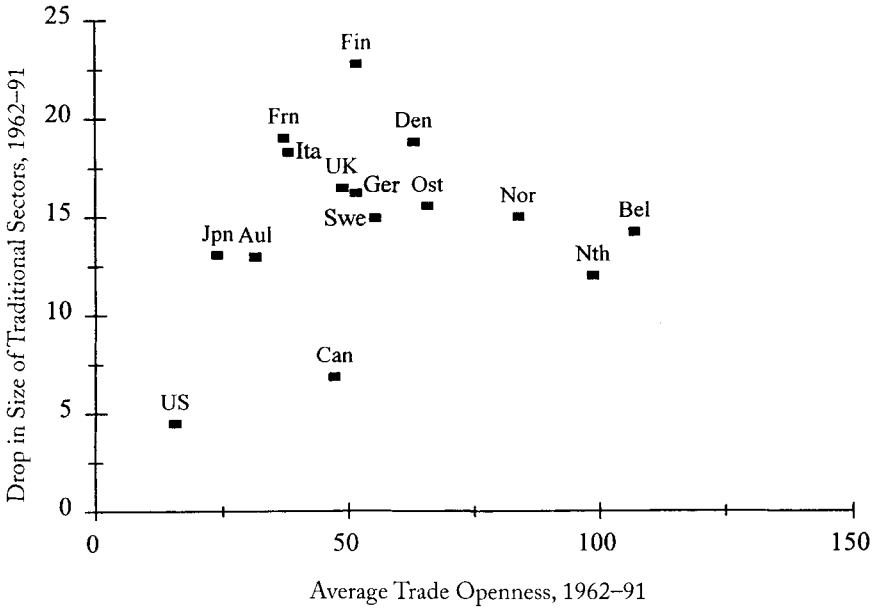

FIGURE 3
TRADE OPENNESS AND LOSSES IN TRADITIONAL SECTORS[a]

[a] Trade openness is exports plus imports as a percentage of GDP; drop in the share of traditional sectors is measured as the change in the percentage of the working-age population engaged in agriculture or industry between 1962 and 1991.

that the removal of restrictions on capital makes it increasingly easier for businesses to relocate production facilities to countries with lower wage costs and that this in turn diminishes the demand for labor within the industrial sectors of the advanced market economies.[64]

The alternative school, while not denying that trade has played a role in deindustrialization, sees the principal causes as residing in domestic sources.[65] Among these are a change in preference patterns away from manufactured goods and toward services, high productivity growth in the face of inelastic demand, as well as the associated changes in in-

[64] Wolfgang Streeck, "German Capitalism: Does It Exist? Can It Survive?" in Colin Crouch and Streeck, eds., *Political Economy and Modern Capitalism: Mapping Convergence and Diversity* (London: Sage, 1997).

[65] Robert Rowthorn and Ramana Ramaswamy, "Deindustrialization: Causes and Implications" (International Monetary Fund Working Paper, no. 42, Washington, D.C., 1997); idem, "Growth, Trade, and Deindustrialization, *International Monetary Fund Staff Papers* 46 (March 1999); Paul Krugman, *Pop Internationalism* (Cambridge: MIT Press, 1996).

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vestment in new productive capacity.[66] North-South trade accounts for at most one-sixth of the loss in manufacturing employment in these studies.[67]

Furthermore, it may indeed be the case that the welfare state is itself responsible for the decline in employment in the traditional sectors. As Bacon and Eltis have argued, both the costs posed by taxation as well as the generosity of the modern welfare state, including the opportunity to work for at least equivalent if not higher wages in the public sector, have had a tremendous negative effect on industrial employment.[68] The notion of efficiency losses from distortionary taxation is in fact a quite common assumption in economic models of the welfare state.[69] It is of course also a view that is popular with political parties and governments of a neoliberal bent.

Figure 3 provides some descriptive evidence on the question of whether trade causes deindustrialization. It plots the loss of employment in the traditional sectors from 1962 through 1991 against the average trade openness for the same period. There is little hint of any relationship. Indeed the correlation between the two series is about 0.17.

Alternatively, if one were to adopt the hypothesis that deindustrialization has more to do with internal processes, processes of productivity gain and shifting tastes, then one would expect that a process of convergence has been under way. Thus, early industrializers, who had pretty much gone through this transformation by the beginning of this period, would have suffered the least loss of employment in the traditional sectors, while late industrializers would have experienced more rapid decline. As Figure 4 demonstrates, there seems to be a fair amount of support for this position. The correlation between employment intensity in the traditional sectors in the year 1962 and the loss of employment in these sectors over the three succeeding decades is about 0.85. Thus, the United States, which had the smallest traditional sectors (about 24 percent), experienced the smallest loss (less than 5 percent). Finland, lagging well behind the United States and having nearly

[66] Rowthorn and Ramaswamy (fn. 65, 1999), 19.

[67] We recognize that the debate over trade with LDC countries is broader than the question of whether it has led to widespread deindustrialization. It also involves issues such as the relative performance of particular manufacturing industries, relative prices, and above all, wage inequality. For a good introduction to the debate see the special issue of *Journal of Economic Perspectives* 9 (Special issue, 1995). For our purposes, however, the key issue is whether or not our main independent variable, deindustrialization, is in large measure the result of competition from low-wage countries.

[68] Robert Bacon and Walter Eltis, *Britain's Economic Problem: Too Few Producers* (London: Macmillan, 1976).

[69] See, for example, Meltzer and Richard (fn. 40); and Alberto Alesina and Roberto Perotti, "The Welfare State and Competitiveness," *American Economic Review* 87 (December 1997).

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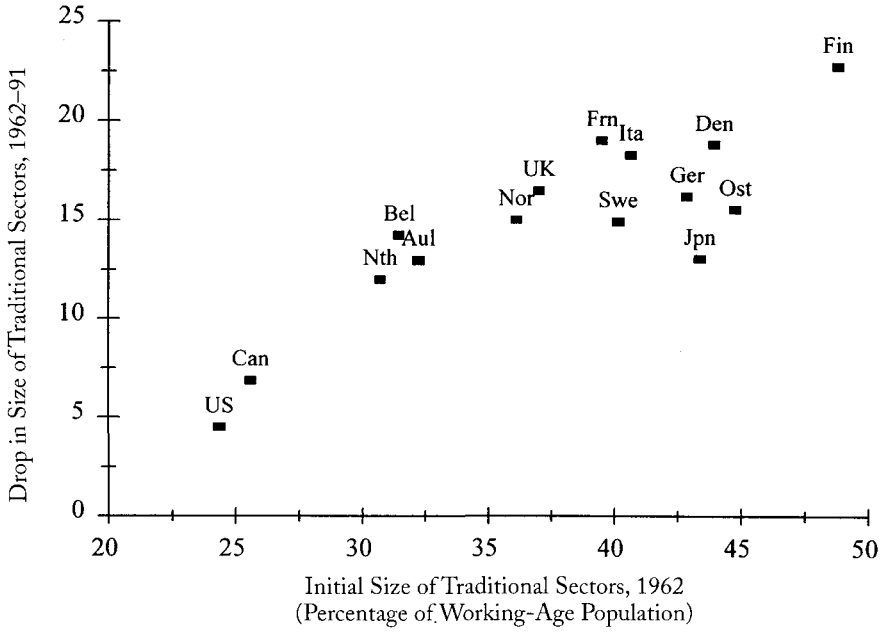

FIGURE 4
INITIAL SIZE AND LOSSES IN TRADITIONAL SECTORS

50 percent of its working-age population engaged in the traditional sectors, experienced the largest loss in the sample of fifteen countries, well over 20 percent.

But descriptive and indirect evidence of this nature can sometimes be misleading. We have therefore estimated a pooled cross-section-time-series model that uses the change in the log of the number of people employed in manufacturing and agriculture as a share of the working-age population as the dependent variable (see Table 4).[70] This setup is standard in the existing literature, except that we have included agricultural employment on the left-hand side to make the results speak directly to our deindustrialization variable.[71] However, the results are very similar if we focus exclusively on manufacturing employment.

[70] As in the previous analysis, problems of heteroskedasticity led us to employ Beck and Katz's method for deriving panel corrected standard errors. Beck and Katz (fn. 50).

[71] We could have used change in the log of the deindustrialization variable on the left-hand side in Table 4 without affecting the results (except for switching the signs of parameters, of course). We chose the current setup to stay as close as possible to the analysis by Rowthorn and Ramaswamy (fn. 65).

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TABLE 4
REGRESSION RESULTS FOR INDUSTRIALIZATION[a]

Domestic Variables		*International Variables*	
[Lagged level]	−0.113***	Capital openness	0.001
	(−5.27)		(0.30)
Productivity growth	−0.353***	Δ Capital openness	0.001
	(9.09)		(0.50)
Income	0.523**	OECD trade balance	0.002***
	(2.18)		(3.47)
Income squared	−0.30**	Δ OECD trade balance	0.004***
	(2.24)		(4.43)
Growth in income	0.585***	OPEC trade balance	−0.004*
	(8.50)		(−1.96)
Capital formation	0.032***	Δ OPEC trade balance	−0.003
	(5.53)		(−1.35)
Government transfers	−0.001	LDC trade balance	−0.003**
	(−0.99)		(−2.12)
Government consumption	0.001	Δ LDC trade balance	−0.002
	(0.30)		(−1.19)
Increase in explained var.	35%		5%
Adjusted R-squared			0.52
Number of observations			378

[a] T-scores in parentheses. The increase in explained variance is the change in R-squared when the set of endogenous and exogenous variables are added to a model where these variables are excluded. The results for country dummies are not shown.

* Significance level: <0.10
** Significance level: <0.05
*** Significance level: <0.01

The analysis includes fourteen OECD countries for which we have complete data in the period from 1964 through 1990.[72]

For presentational ease Table 4 divides the independent variables in a group of "domestic" variables and a group of "international" variables. Following the existing economic literature we include among the domestic-structural variables: (1) a measure of productivity growth, (2) the log of income per capita and the square of this variable to capture

[72] The countries include: Austria, Belgium, Canada, Denmark, Finland, France, Germany, Italy, Japan, Netherlands, Norway, Sweden, the United Kingdom, and the United States. Missing data problems precluded adding Switzerland. The time frame is the maximum possible given the availability of data.

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changing consumption preferences, (3) the growth in per capita income as a measure of demand effects, (4) gross capital formation as a share of GDP, and (5) the two spending variables. For the exogenous variables we have included (1) the balance of trade with OECD, with OPEC, and with less-developed countries (LDCs); and (2) the capital market openness variable used above.

The productivity measure is meant to capture the tendency of firms to shed workers as productivity increases. Note that there is some theoretical ambiguity with respect to the impact of this variable. While faster productivity growth makes goods relatively cheaper and therefore boosts demand, less labor is required to produce the same amount of output. The net effect on employment depends on the price and income elasticity of demand as well as on real wage changes. Research, however, has shown that the labor saving effect tends to dominate the demand effect in the period of interest.[73] For the income terms, the expectation is that the parameter on the first term will be positive and that on the second term will be negative, signifying that as income passes beyond a certain level, the relative demand for goods in both the agricultural and manufacturing sectors will begin to decline. The effects of capital formation and growth in income are expected to be positive since both will boost production and demand for labor.[74]

The results are generally very supportive of our argument. Deindustrialization is almost exclusively driven by domestic factors other than the welfare state. Technological progress, demand conditions, and shifting consumption patterns cause employment in industry and agriculture to decline. Evidence does not show that government spending has crowded out employment in the traditional sectors. Given our previous findings, every indication is that the causal arrow goes in the opposite direction. Trade also does not appear to be an important source of deindustrialization. A negative trade balance with other industrialized countries (and the first difference in that trade balance) does hurt industrial employment. The effect is substantively small, however, and cannot have been a major cause of deindustrialization across the OECD area for the simple reason that intra-OECD trade remains relatively balanced over time.

The crucial question with respect to trade is whether growing trade with less-developed countries has priced out a substantial number of

[73] See Appelbaum and Schettkat (fn. 59); and idem, "The End of Full Employment? On Economic Development in Industrialized Countries," *Intereconomics* 29 (May–June 1994).

[74] Investment is measured as a percentage share of GDP. It is taken from the Robert Summers and Alan Heston, *Penn World Tables*, version 5.5, datafile (Cambridge: National Bureau of Economic Research, 1993).

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workers in agriculture and industry in the advanced countries. We find no evidence to that effect. The coefficients on the lagged levels of the trade balances with OPEC countries and with Third World countries are both negative and statistically significant, while both of the coefficients on the first differences are statistically insignificant. Note, that these results, which suggest that positive trade balances with the OPEC and Third World countries lower employment while negative balances promote employment, are not the consequence of multicollinearity. Also, their effects do not change in substantive terms when we use alternative specifications of the model. We have run a large number of regressions using a variety of combinations of trade balances and import penetration measures, and the results are *all* contrary to the hypothesis that trade leads to deindustrialization. In fact, the results in Table 4 are the strongest we have been able to produce in *support* of the popular perception.[75] The same is true for the capital-market-openness variable which consistently fails to produce effects that are statistically distinguishable from zero.

Though surprising given popular views, our results essentially replicate those in an OECD study by Rowthorn and Ramaswamy,[76] even though our data and model specification are somewhat different. Like Rowthorn and Ramaswamy we find that deindustrialization is driven primarily by deep economic processes that are unrelated to either openness or spending. Productivity growth in the traditional sectors leads to a loss in employment, whereas rising demand through growing investment or incomes has a positive effect. Consistent with Engel's law, the results also indicate that demand for agricultural and manufacturing first rises with income and then falls at higher levels thereby eventually diminishing the level of traditional employment. We conclude from this analysis that our argument and results for spending are robust to the charges that deindustrialization is a mediating variable and that its association with spending is a result of reversed causality.

Conclusion

The domestic effects of the international economy has been increasingly emphasized in political-economic theory as well as popular accounts. There is no denying that international trade and financial liberalization have heightened interdependence among states and

[75] The results of alternative specifications are available from the authors upon request.
[76] Rowthorn and Ramaswamy (fn. 65, 1999).

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played an increasingly important role in shaping public policy. The causal primacy of these factors in shaping the dimensions of the welfare state, however, appears to be greatly exaggerated.

A concomitant aspect of this exaggeration of global factors is the neglect of domestic forces of change—forces that are driven by technological advance and shifting demand patterns. These forces have caused massive shifts in the employment structure, the most notable being the shift from manufacturing to services. Because people often have skills that travel poorly between these sectors and because employer-provided social insurance is limited by a firm or by industry, deindustrialization poses significant risks that can be addressed only through government expansion of social security and public employment. In future work, the transferability of skills will be an important focus because the political effects of changes in the occupational structure depends on it. For example, a country like Germany with a training system that emphasizes specific skills will be politically more sensitive to occupational shifts than a country like the U.S. where the educational system emphasizes general skills.

Why has the role of deindustrialization been ignored in explanations of welfare state expansion? We suspect that one reason is a misconception that the shift in the employment structures is relatively uniform across countries, a common mistake in political science.[77] As we document in the introduction, there is in fact tremendous variation in the extent of deindustrialization, and our empirical results demonstrate that this factor can account for a very significant proportion of the variance in welfare state spending. Another reason for the omission is undoubtedly an outgrowth of the idea, deeply ingrained in most of our theories of comparative political economy, that the rise of the welfare state is linked to the strength of the industrial working class. What our analysis suggests is that any major transformation in the employment structure, whether from agriculture to industry or from industry to services, produces insecurities in the labor market that propel demands for state intervention.

Governments of all political stripes have responded to these demands by expanding transfer payments and social service provision. Nevertheless, partisanship continues to be important in the redistributive aspects of the welfare state. This shows up clearly in the results for public consumption, which has expanded much more rapidly in coun-

[77] Jonas Pontusson, "Explaining the Decline of European Social Democracy: The Role of Structural Economic Change," *World Politics* 47 (July 1995).

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tries where the left is strong. We would conjecture that the same is true for transfer payments if the composition, rather than the level, of spending is examined.

In fact, there are reasons to expect that deindustrialization will be associated with increasingly distinct partisan effects. First, due to gaps in productivity growth across sectors, egalitarian policies tend to inhibit the expansion of private service sector employment. These policies present the government with an increasingly clear choice between either excluding more and more people from the labor market or employing more of them in public service sector jobs. Second, with the process of sectoral transformation coming to an end in many countries, the political support for further welfare state expansion is likely to wane, whereas distributive conflicts over existing welfare state programs are likely to intensify. We believe that these political aspects of deindustrialization are promising areas for future research.

Appendix: Glossary of Variables and Data Sources

$$automatic\ consumption = \frac{gov\ consumption}{GDP}(t-1) \cdot \left(\frac{\Delta gov\ deflator(t)}{gov\ deflator\,(t-1)}\right) / \left(\frac{\Delta GDP\ deflator(t)}{GDP\ deflator(t-1)}\right),$$

where gov deflator is the price deflator for government services, and GDP deflator is the price deflator for the whole GDP.

$$automatic\ transfers = replacement\ rate(t-1) \cdot \Delta \frac{unemployed + population > 65}{population}(t),$$

where the replacement rate is the percentage share of transfers in GDP relative to the percentage share of the dependent population in the total population at time t − 1.[78]

capital formation. Gross capital formation as a percent of GDP.[79]

capital market openness. The index measures the extent to which capital markets are liberalized.[80]

[78] OECD, *Labour Force Statistics* (Paris: OECD, various years); and transfer data.

[79] Summers and Heston (fn. 74).

[80] Denis P. Quinn, and Carla Inclan, "The Origin of Financial Openness: A Study of Current and Capital Account Internationalization," *American Journal of Political Science* 41, no. 3 (1997).

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deindustrialization. 100 minus the sum of manufacturing and agricultural employment as a percentage of the working-age population.[81]

electoral participation. Based on voter turnout rates as recorded on an annual basis in Mackie and Rose,[82] the *European Journal of Political Research*, and in the International Institute for Democracy and Electoral Assistance.[83]

excluded labor. 100 minus all employed people as a percent of the total population (change in this variable when used as a dependent variable).

generosity of transfers. The percentage share of transfers in GDP relative to the percentage share of the nonworking population in the total population (change in this variable when used as dependent variable).[84]

government consumption. Total government consumption of goods and services net of military spending as a percentage of GDP.[85]

government transfers. All government payments to the civilian household sector, including social security transfers, government grants, public employee pensions, and transfers to nonprofit institutions serving the household sector.[86]

income. Gross domestic product per capita in purchasing power equivalents in 1985 U.S. dollars.[87]

left government center of gravity. This is an index of the partisan left-right "center of gravity" developed by Cusack.[88] It is based on (1) Castles and Mair's codings of government parties placement on a left-right scale,[89] weighted by (2) their decimal share of cabinet portfolios. The index varies from 0 (extreme right) to 4 (extreme left), although most observations are much closer to the mean.

private sector labor surplus. Deindustrialization minus the private service sector employment as a percent of the working-age population (change in this variable when used as dependent variable).

[81] OECD (fn. 78).

[82] Thomas T. Mackie and Richard Rose, *The International Almanac of Electoral History*, 3d ed. (London: Macmillan, 1991).

[83] International Institute for Democracy and Electoral Assistance, *Voter Turnout from 1945 to 1997: A Global Report on Political Participation* (Stockholm: IDEA Information Services, 1997).

[84] OECD (fn. 78); and transfer data.

[85] Thomas Cusack, "The Changing Contours of Government" (Wissenschaftszentrum Berlin für Sozialforschung, WZB Discussion Paper, no. 304, 1991); OECD (fn. 78); Stockholm International Peace Research Institute, *The SIPRI Year Book* (Stockholm: SIPRI, various years).

[86] Cusack (fn. 85); and OECD, *National Accounts, Part II: Detailed Tables* (Paris: OECD, various years).

[87] Summers and Heston (fn. 74).

[88] Cusack (fn. 24, 1997).

[89] Francis Castles and Peter Mair, "Left-Right Political Scales: Some 'Expert' Judgments," *European Journal of Political Research* 12, no. 1 (1984).

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productivity growth. Annual rate of change in real value added per worker in industry and agriculture.[90]

strength of labor. Measured as the product of union density and centralization.[91]

trade balances. Merchandise trade balance expressed as a percent of GDP for three country groupings (OECD, OPEC, LDCs).[92]

trade openness. Total exports and imports of goods and services as percentage of GDP.[93]

unexpected growth. Real GDP per capita growth at time t minus average real per capita growth in the preceding three years. The variable is defined in accordance with Roubini and Sachs.[94]

[90] OECD, *National Accounts CD-Rom* (Paris: OECD, 1995).

[91] Density data: Jelle Visser, *European Trade Union in Figures* (Deventer, Netherlands: Kluwer Law and Taxation Publishers, 1989); and idem, "Unionization Trends Revisited" (Manuscript, University of Amsterdam, 1996). Centralization data: Torben Iversen, "Wage Bargaining, Central Bank Independence and the Real Effects of Money," *International Organization* 52 (Summer 1998).

[92] IMF, *Direction of Trade Statistics Yearbook* (Washington, D.C.: IMF, various years).

[93] OECD (fn. 86).

[94] Roubini and Sachs (fn. 23); and OECD (fn. 86).

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WAGE INEQUALITY AND VARIETIES OF CAPITALISM

By DAVID RUEDA and JONAS PONTUSSON*

THE immediate goal of this article is to explore the determinants of wage inequality in advanced capitalist economies. Following a period in which the distribution of wages tended to become more compressed, most OECD countries have experienced some increase in wage inequality since 1980. However, the magnitude of change varies significantly across these countries: the rise of wage inequality began earlier and/or lasted longer in some countries than in others. As we shall see, the United States stands out as the OECD country that has experienced the most sustained rise of wage inequality, lasting at least a quarter of a century. With countries entering the 1980s at very different levels of wage inequality, the persistence of cross-national diversity remains a conspicuous feature of the data that we present below. In 1995 someone occupying the 90th percentile of the U.S. earnings distribution (the bottom of the top 10 percent) had an income that was 4.6 times larger than the income of someone in the 10th percentile (the top of the bottom 10 percent). At the opposite end of the spectrum, the 90–10 earnings ratio in Sweden was only 2.2 in 1995.

To date, most of the literature on the comparative political economy of labor markets has taken macroeconomic performance as the dependent variable and focused on the issue of wage restraint, or the trade-off between inflation and unemployment. In the corporatist tradition inspired by rational choice thinking, wage restraint is viewed as a public good, subject to familiar collective action problems, and divergent outcomes are typically explained in terms of institutional arrangements, which determine the ability of unions and/or employers to coordinate their wage-bargaining behavior. As we turn to explore wage-distributive outcomes, this line of thinking seems less compelling, for any number of (particular) wage distributions satisfy the conditions of Pareto

* This article has a long history: earlier versions have been presented in numerous forums, and a great many people have commented on the research presented here. We are especially grateful to Rob Franzese, Geoffrey Garrett, Torben Iversen, Walter Mebane, Michael Wallerstein, Chris Way, and Bruce Western for their constructive criticisms, technical assistance, and encouragement.

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optimality. If the politics of wage restraint is essentially about coordination, trust, and perhaps sanctions to avoid a suboptimal outcome, the politics of wage distribution is more accurately described in terms of a continuous process of negotiating temporary settlements among competing interests.

In the real world the politics of wage restraint and the politics of wage distribution are, of course, opposite sides of the same coin, but as our analytical focus shifts from the former to the latter, we might expect that variables which capture the power resources of organized interests, such as union density and government partisanship, take on greater explanatory significance relative to more formal institutional variables, such as the degree of centralization of wage bargaining. Equally important, this shift of focus invites us to think differently about institutional arrangements. If centralization of bargaining matters to wage-distributive outcomes, this is not because it provides for coordination but rather because it affects the distribution of power among actors in the bargaining process.[1]

Quantitatively inclined comparativists are turning increasingly to pooled cross-section time-series regression analysis because it allows them to increase the total number of observations and to test relatively complex causal models with aggregate data from a small number of countries. Nevertheless, for all the sophistication of this recent quantitative work, more qualitatively inclined scholars still cling to the essential historical-institutionalist objection to regression analysis—that it presupposes but does not prove that the relationship between independent variable X and dependent variable Y is the same across all units of observation. The radical version of this objection holds that each country should be conceived as a unique context, determining the relationship between X and Y. More commonly in comparative political economy, we are told that countries cluster into a few broad, historically constituted institutional configurations. The arguments advanced by Katzenstein, Hall, Esping-Andersen, and Soskice imply that changing the value of X will have certain effects in one set of countries and quite different effects in another.[2]

[1] Cf. Michael Wallerstein, "Wage-Setting Institutions and Pay Inequality in Advanced Industrial Societies," *American Journal of Political Science* 43 (July 1999).

[2] Peter Katzenstein, *Small States in World Markets* (Ithaca, N.Y.: Cornell University Press, 1985); Peter Hall, *Governing the Economy* (New York: Oxford University Press, 1986); Gøsta Esping-Andersen, *The Three Worlds of Welfare Capitalism* (Princeton: Princeton University Press, 1990); David Soskice, "Wage Determination," *Oxford Review of Economic Policy* 6 (Winter 1990); and idem, "Divergent Production Regimes," in Herbert Kitschelt et al., eds., *Continuity and Change in Contemporary Capitalism* (New York: Cambridge University Press, 1999).

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Behind our immediate goal of exploring the determinants of wage inequality, the ulterior purpose of this article is to show that regression analysis can and should incorporate the insights of the approach associated with these scholars.[3] Exploring the common determinants of wage inequality across nations and over time we seek to determine whether and how these determinants vary across varieties of capitalism. Drawing on a new data set collected by the OECD, we engage in two rounds of pooled regression analysis. In the first round we regress levels of wage inequality on unemployment rates, trade with low-wage countries, female labor-force participation, union density, centralization of wage bargaining, the public sector's share of total employment, and government partisanship. Although the first three variables are meant to capture supply-and-demand conditions, none of them turns out to be a consistent predictor of the observed variance in wage inequality; the other four variables, however, all have statistically and substantively significant coefficients. Our second regression setup adds further institutional complexity by distinguishing between social market economies (SMEs) and liberal market economies (LMEs).

To anticipate, our empirical results indicate that varieties of capitalism matter. We find some support for the proposition that SME conditions mute the impact of market forces on the distribution of wages. More importantly, our results show that SME conditions significantly affect either the direction or the magnitude of most of our political and institutional variables. Of particular interest to political scientists is the finding that the wage-distributive effects of government partisanship are contingent on institutional context. While leftist governments are associated with less wage inequality in liberal market economies, this is not the case in social market economies. Union density emerges as the single most important factor influencing wage inequality across institutional contexts; its effects are consistently egalitarian and they are greater than those of any other independent variable within the country clusters. Our results thus support the contention that the politics of wage distribution involves conflicts between unions and employers as well as distributive conflicts between different firms and different categories of wage earners.

[3] In seeking to incorporate institutional insights into regression analysis, we follow the lead of Bruce Western, *Between Class and Market* (Princeton: Princeton University Press, 1997); Geoffrey Garrett, *Partisan Politics in the Global Economy* (New York: Cambridge University Press, 1998); and Torben Iversen, *Contested Economic Institutions* (New York: Cambridge University Press, 1999). However, none of these works explicitly tests the idea that causal dynamics vary by political economy type. Previous work in this particular vein includes Philip O'Connel, "National Variations in the Fortunes of Labor," in Thomas Janoski and Alexander Hicks, eds., *The Comparative Political Economy of the Welfare State* (New York: Cambridge University Press, 1994); and Duane Swank, "Political Institutions and Welfare State Restructuring," in Paul Pierson, ed., *The New Politics of the Welfare State* (New York: Oxford University Press, 2000).

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We begin by describing the wage-distributive outcomes that we seek to explain. We then review the literature on the determinants of wage inequality and generate causal hypotheses pertaining to the discrete independent variables identified above. Third, we elaborate on the distinction between social and liberal market economies and specify how we expect this distinction to affect our causal hypotheses. The fourth section briefly addresses methodological issues, and the fifth section presents our empirical results. By way of conclusion, we address the general implications of our analysis.

I. Patterns of Wage Inequality

The dependent variable in our analysis is a summary measure of the distribution of gross income from employment. The particular measure we use, the ratio of earning at the 90th percentile to earnings at the 10th percentile, is dictated by the OECD data set on which we rely. The 90–10 ratio, a measure of the distance between two points, certainly does not tell us everything about the overall shape of the distribution, but it is a commonly used measure and easy to interpret.

The reader should keep in mind that our inequality measure ignores important sources of income, such as self-employment, income from capital, and government transfers. It also ignores the distributive effects of taxation and income pooling within households. Moreover, the OECD data set on which we rely is restricted to full-time employees (except in the case of Austria). What follows, then, must not be confused with an analysis of the overall distribution of income in OECD countries. This said, income from employment accounts for the lion's share of income in all OECD countries, and the distribution of income from employment, as measured by 90–10 ratios, correlates quite closely with broader cross-national measures of income distribution.[4]

Figures 1 and 2 provide a graphic summary of the wage-distributive outcomes that our analysis seeks to explain. The figures reveal both persistent variations in levels of wage inequality among the sixteen OECD countries and considerable change over time. Starting with the persistence of cross-national variations, the U.S. and Canada clearly constitute a group unto themselves, distinguished by very high levels of wage inequality throughout the time period covered by our data. At the other

[4] Cf. Wallerstein (fn. 1), 649; OECD, *Income Distribution in OECD Countries: Evidence from the Luxembourg Income Study* (OECD, 1995); and Peter Gottschalk and Timothy Smeeding, "Cross-National Comparisons of Earnings and Income Inequality," *Journal of Economic Literature* 35 (June 1997). For further specifications of the wage data used here, see OECD, "Earnings Inequality, Low-Paid Employment and Earnings Mobility," *Employment Outlook* (July 1996).

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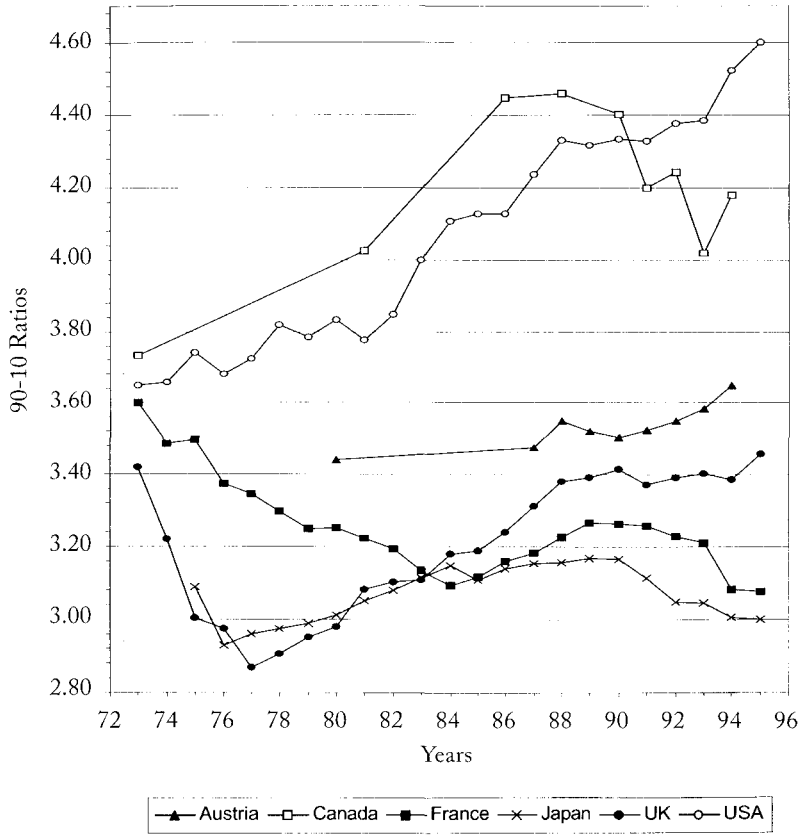

FIGURE 1

SOURCE: See appendix.

end of the spectrum the Scandinavian countries (Sweden, Norway, and Denmark) stand out as the OECD countries with the most egalitarian distribution of wages. The Scandinavian countries might be viewed as part of a broader low-inequality band that would also include Belgium, Finland, Italy, Switzerland, the Netherlands, Germany, and possibly Australia. Alternatively, the latter group of countries might be viewed as a separate, low-to-average band. In any case, Japan, France, the United Kingdom, and Austria make up another band, characterized by comparatively high levels of wage inequality, though not nearly as high as those of Canada and the U.S.[5] While relative rankings within these

[5] The high level of wage inequality in Austria is partly attributable to the fact that the underlying wage data include part-time employees, but other data sources also indicate that the Austrian distribution of wages is quite inegalitarian by continental European standards. See Bob Rowthorn, "Corporatism and Labour Market Performance," in Jukka Pekkarinen, Matti Pohjola, and Bob Rowthorn,

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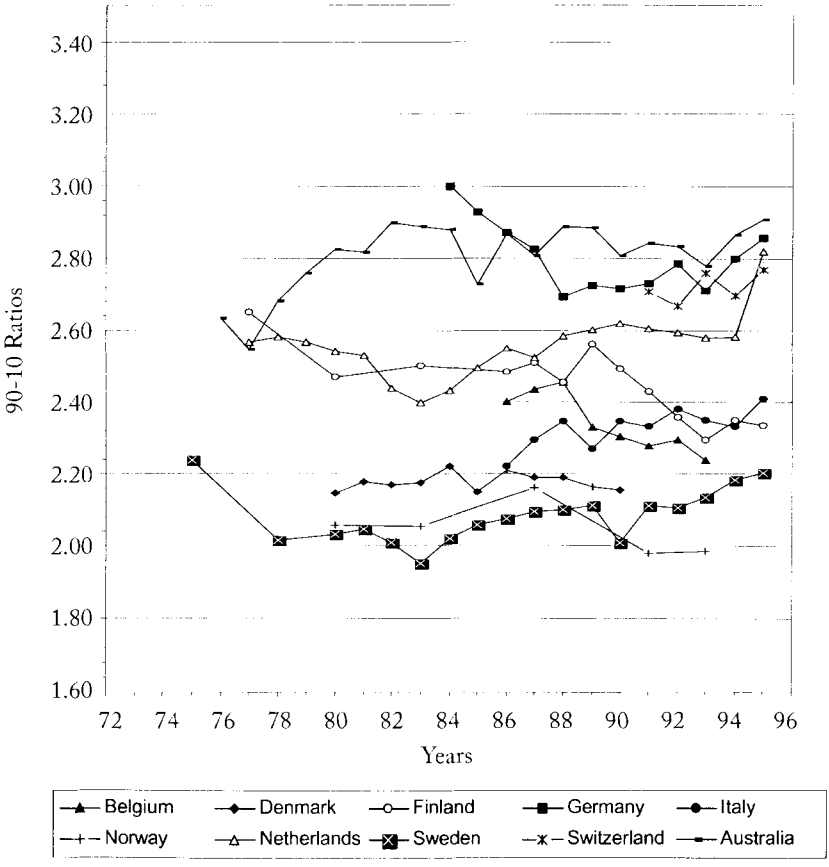

FIGURE 2

SOURCE: See appendix.

bands changed, the country composition of the bands remained remarkably stable over the 1973–95 period.

Looking at change over time, seven countries have experienced a continuous rise in wage inequality in recent years—most dramatically, the U.S. and the U.K, but also Austria, Germany, the Netherlands, Italy, and Sweden. In another four countries (Canada, France, Japan, and Australia), we observe notable increases of wage inequality in the 1970s and the 1980s, followed by subsequent decreases or, in the case of

eds., *Social Corporatism* (Oxford: Clarendon Press, 1992); and Jonas Pontusson, "Wage Distribution and Labor Market Institutions," in Torben Iversen, Jonas Pontusson, and David Soskice, eds., *Unions, Employers and Central Banks* (New York: Cambridge University Press, 2000). The use of country dummies and the small number of Austrian observations (7) renders our analysis essentially unaffected by the exceptional nature of the Austrian wage data.

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TABLE 1
PERCENTAGE INCREASE IN 90–10 RATIOS FROM ALL-TIME TROUGH TO MOST RECENT OBSERVATION

Country	*% Change*	*Trough*	*Most Recent*
United States	26.0	1973	1995
United Kingdom	20.6	1977	1995
Netherlands	17.5	1983	1995
Australia	14.1	1977	1995
Sweden	12.8	1983	1995
Canada	12.1	1973	1994
Italy	8.6	1986	1995
Germany	6.3	1988	1995
Austria	6.1	1980	1994
Switzerland	3.7	1992	1995
Japan	2.4	1976	1995
Finland	1.7	1993	1995
Belgium	0.0	1993	1993
Denmark	0.0	1990	1990
France	0.0	1995	1995
Norway	0.0	1993	1993

SOURCE: See appendix.

Australia, a period of stability. Norway, Denmark, and Switzerland seem best characterized as cases of long-term stability while Finland and Belgium stand out as the two countries in which wage inequality declined continuously in the 1980s and 1990s. Measuring the percentage change in 90–10 ratios from their all-time trough to the most recent observation available, Table 1 brings out the widespread trend toward increased wage inequality, as well as important cross-national variations in its duration and magnitude.[6]

II. LITERATURE REVIEW AND HYPOTHESES

The labor economics approach to the problem of explaining wage-distributive outcomes focuses on relative demand for and supply of dif-

[6] The trend for wage inequality becomes more impressive if we look at the wage distribution among men and women separately. See OECD (fn. 4, 1996); and Jonas Pontusson, David Rueda, and Christopher Way, "The Role of Political-Institutional Variables in the Making of Gendered Patterns of Wage Inequality" (Working paper, Institute for European Studies, Cornell University, 1999). In most countries increases of within-gender inequality have been offset by continued compression of between-gender wage differentials.

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ferent types of labor. Looking at the demand side, labor economists typically argue that the growth of wage inequality in the U.S. and elsewhere reflects technological changes, which have rendered more-educated workers more valuable to employers than less-educated workers. With regard to the supply side, labor economists frequently point out that the compression of wage differentials prior to the 1970s coincided with rapid growth of university enrollments, that is, with an increase in the relative supply of educated labor. As the growth of university enrollments decelerated, the supply of better-educated labor subsequently failed to keep up with demand, giving rise to sharply increasing returns to education. At the same time, immigration and, more broadly relevant to all OECD countries, the massive increase in women's participation in the labor force since the 1970s represent an increase in the relative supply of unskilled labor to the extent that immigrants and women are on average less educated and less experienced than "native" men.[7]

In a similar vein, Wood argues that much of the trend toward increased wage inequality in the OECD countries in the 1980s can be attributed to increased manufacturing trade with less developed countries.[8] Though his empirical analysis is controversial, the logic of his argumentation is consistent with the supply-and-demand framework of the labor economics approach: as imports of less skill-intensive goods from low-wage countries increase, the effective supply of unskilled labor relative to skilled labor increases, putting downward pressure on the relative wages of unskilled workers.

Labor economists who engage in cross-national comparison typically find that supply-and-demand factors alone cannot explain observed variations in wage inequality across the OECD countries; they conclude that institutions matter.[9] When economists speak of "institutions," they have in mind not only codified rules or formalized organizational arrangements but also government policy and the distribution of power among organized interests. Commonly, the sectoral distribution of employment and other dimensions of industrial structure are also referred to as institutional variables. From the perspective of comparative political economy, the interesting question is not whether in-

[7] Robert Topel, "Wage Inequality and Regional Labor Market Performance in the United States," in Toshiaki Tachibanaki, ed., *Labour Market and Economic Performance* (New York: St. Martin's Press, 1994); and Lars Svensson, *Closing the Gender Gap* (Lund: Ekonomisk-Historiska Föreningen, 1995).

[8] Adrian Wood, *North-South Trade, Employment and Inequality* (Oxford: Clarendon Press, 1994).

[9] Gottschalk and Smeeding (fn. 4); Rowthorn (fn. 5); Francine Blau and Lawrence Kahn, "International Difference in Male Wage Inequality," *Journal of Political Economy* 104 (August 1996); and various contributions to Richard Freeman and Lawrence Katz, eds., *Differences and Changes in Wage Structures* (Chicago: University of Chicago Press, 1995).

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stitutions in this broad sense matter but rather which institutions matter and how (why) they matter. In this spirit, we seek to isolate the causal effects of different political-institutional variables and to explore interactions among those variables.

As a first cut, we derive four relevant political-institutional variables from the literature: unionization, centralization of wage bargaining, the size of the public sector, and the partisan composition of government. Ideally, we would want to control for all the relative supply-and-demand factors identified by labor economists as we estimate the effects of these variables. Measuring relative demand shifts associated with new technology is notoriously difficult, however, and we have not been able to find any such measure that would suit our purposes. Moreover, the existing OECD data on immigration flows are not comparable across countries and OECD data on educational qualifications exist only for the second half of the time period covered by our wage-inequality data.

Thus we are left with two control variables meant to capture cross-national variations and variations over time in the relative supplies of skilled and unskilled labor: non-OPEC LDC trade as a percentage of GDP and women's share of total employment. For the reasons set out above, we hypothesize that both variables are positively associated with wage inequality. With respect to female labor-force participation, some preliminary qualifications are in order, for we know the 1970s and early 1980s were characterized by a significant increase of female labor-force participation, as well as a significant decline of wage inequality in many OECD countries. Our baseline hypothesis implies that other factors, such as increased female participation in higher education and the expansion of public sector jobs, offset the inegalitarian effects of female labor-force participation in this period, but it is also plausible that the wage-distributive effects of female labor-force participation itself are contingent or contradictory. As women acquire skills through labor-force participation, higher levels of female labor-force participation should be associated with a smaller skill gap between men and women.

The regressions reported below also include the rate of unemployment to capture the wage-distributive effects of aggregate demand fluctuations (as distinct from relative demand shifts). It is a commonplace that unskilled, low-paid workers are more readily substitutable than skilled, high-paid workers and that their bargaining position is more immediately and more adversely affected by unemployment. By this logic, we expect the rate of unemployment to be positively associated with wage inequality.[10]

[10] Cf. James Galbraith, *Created Unequal* (New York: Free Press, 1998).

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However, there is another side to the relationship between unemployment and wage inequality, for employers are more likely to lay off unskilled workers than to lay off skilled workers during economic downturns. To the extent that an increase in unemployment entails a disproportionate loss of low-paid jobs, it should be associated with less rather than more wage inequality (though it would still be associated with more overall inequality of income). For both female labor-force participation and unemployment, then, our theoretical expectations are somewhat ambiguous. Still, it is desirable to include these variables as controls. Let us now turn to the variables of primary theoretical interest.

Union Density

Following Freeman, we should distinguish two dimensions of the relationship between unionization and wage distribution: one concerns the distribution of wages among union members and how it compares with the distribution of earnings among unorganized wage earners; the other concerns wage differentials between union members and nonmembers, that is, the wage premium associated with union membership for wage earners with equivalent qualifications, experience, and other relevant characteristics.[11] With respect to the first dimension, there are several reasons to expect the wage distribution of the union sector of an economy to be more compressed than that of the nonunion sector. To begin with, unions approximate the logic of democratic decision making (one person, one vote) more closely than markets do, and whenever the mean wage exceeds the median wage, we would expect a majority of union members to favor redistributive wage demands. Moreover, because unions are dependent on membership support in conflicts with management, they have a strong interest in curtailing wage setting based on the subjective decisions of foremen or personnel managers.

While employers competing in the same product markets can be expected to favor standardization of wage rates across firms, thereby taking wages out of competition, they also have an interest in maintaining unilateral control of intrafirm differentials.[12] Moreover, union interest in interfirm standardization is probably deeper and more general than that of employers. Even when market conditions differ among firms, so that price discrimination by the union is possible, the need to sustain mobilizational capacity inclines unions to restrict the scope of interfirm differentials.

[11] Richard Freeman, "Unionism and the Dispersion of Wages," *Industrial and Labor Relations Review* 34 (October 1980); idem, "Union Wage Practices and Wage Dispersion within Establishments," *Industrial and Labor Relations Review* 36 (October 1982); cf. also Blau and Kahn (fn. 9).

[12] Cf. Freeman (fn. 11, 1980).

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To the extent that unionized workers earn more than equivalent nonunionized workers, the relationship between unionization and wage distribution becomes more complicated, for the wage-distributive effects of unionization now come to depend in part on the distribution of union membership across the wage hierarchy. Unionism would be a source of wage inequality if highly paid wage earners were better organized than low-paid workers, and the opposite would hold if low-paid wage earners were better organized. Though we lack detailed information on the distribution of union membership by income, the available evidence suggests that in most countries any wage premiums that accrue to union members are likely to compress the wage distribution.[13] Overall, then, we expect union density to be negatively associated with wage inequality.

Wage-Bargaining Centralization

A number of recent studies establish that countries with more centralized wage-bargaining systems consistently tend to have a more compressed distribution of wages than countries with less centralized wage-bargaining systems.[14] Centralization facilitates the reduction of interfirm and intersectoral wage differentials, since it means that more firms and sectors are included in a single wage settlement, but this argument presupposes that at least one of the parties of centralized bargaining wants to achieve a reduction of interfirm or intersectoral differentials. Wallerstein articulates two mechanisms whereby centralization produces egalitarian outcomes: there is a political mechanism through which centralization alters "the influence of different groups in the wage-setting process," and then there is an ideological mechanism whereby centralization affects norms of fairness.[15]

In the paradigmatic Swedish case, low-wage affiliates of the powerful confederation of blue-collar unions (Landsorganisationen) insisted on solidaristic measures as a condition for their participation in peak-level bargaining sought by employers in the 1950s.[16] But why should centralization systematically strengthen the relative bargaining power

[13] The Eurobarometer of June–July 1994 yields the following figures for average union density by income quartile in the EU member states: lowest quartile, 37.5 percent; second-to-lowest quartile, 37.8 percent; second-to-highest quartile, 34.2 percent; and highest quartile, 23.7 percent. For all countries but Canada the union-density data used in our regressions refer to net rather than gross union density ("employed union members as a percentage of the employed labor force" rather than "union members as a percentage of the total labor force").

[14] Wallerstein (fn. 1); Iversen (fn. 3), 2–5; Rowthorn (fn. 5); Blau and Kahn (fn. 9); and OECD, "Economic Performance and the Structure of Collective Bargaining," *Employment Outlook* (July 1997).

[15] Wallerstein (fn. 1), 674.

[16] Peter Swenson, *Fair Shares* (Ithaca, N.Y.: Cornell University Press, 1989), 56–58.

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of low-wage unions? Wallerstein's political explanation essentially reproduces Freeman's argument about a single union that formulates wage demands on the basis of some form of majoritarian decision making: if low-wage and high-wage unions bargain jointly, organizational politics will influence the demands that they pursue, and market forces will be less influential in determining the distribution of wage increases. Consistent with Wallerstein's ideological explanation, we also hypothesize that centralized bargaining—in the extreme, a single settlement for all wage earners—renders wage differentials more transparent and thus politicizes wage-distributive outcomes. By this logic, centralization not only empowers low-wage unions but also makes them more likely to demand redistributive measures.

To test these hypotheses, which imply a negative association between centralization and wage inequality, we rely on an index of wage-bargaining centralization developed by Iversen.[17] This index takes into account the degree of union concentration at different levels of wage bargaining, as well as the relative importance of local, sectoral, and national bargaining.[18]

Government Employment

Kahn observes a negative association between the size of the public sector (relative to total employment) and wage inequality and explains this association by arguing that countries expand government employment in response to the employment-dampening effects of wage compression.[19] By contrast, we want to suggest that the size of the public sector may be construed as a cause of wage-distributive outcomes. Conceived in this fashion, the relationship between government employment and the overall distribution of wages is twofold, just like the relationship between unionization and wage distribution: first, there is the question of how the distribution of wages in the public sector compares with the distribution of wages in the private sector, and second there is the question of wage differentials between these sectors and how they affect the overall distribution of wages.

There are several reasons to expect wages in the public sector to be more compressed than wages in the private sector, aside from the fact

[17] For a detailed specification, see Iversen (fn. 3), 83–86.

[18] To capture the inertia associated with institutional change, these yearly figures were lagged so that the value for a given year used in our regressions is the average for that year and the previous four years. It should also be noted that we have extrapolated centralization values for the last two years of our time series.

[19] Lawrence Kahn, "Wage Inequality, Collective Bargaining and Relative Employment 1985–94" (Working paper, Institute for Labor Market Policies, Cornell University, 1999).

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that the public sector is more heavily unionized than the private sector in most OECD countries.[20] On average, public sector unions appear to be more inclined than their private sector counterparts to favor wage solidarity. This generalization certainly holds for the 1970s and 1980s, when public sector employers also appear to be more inclined than private sector employers to accommodate union demands for compression or even to initiate compression. While sheltered from competition in product markets, public sector employers are more directly exposed to political pressures in an egalitarian direction, being directly accountable to elected officials. By the same token, public sector unions have had less reason to worry about any potential trade-off between wage compression and employment growth than their private sector counterparts have had.[21]

As with union density, then, we expect the size of the public sector to be negatively associated with wage inequality because wage differentials are more compressed within the public sector. However, public sector wage premiums are much less likely to be egalitarian than are union wage premiums.[22] After all, government employees include a great many well-educated and highly paid civil servants and other professionals. Hence our expectations for the overall impact of the size of the public sector on wage inequality are somewhat uncertain. It seems likely that the effects of this variable are contingent on other institutional variables.

Government Partisanship

There are good reasons to expect leftist parties to pursue redistributive policies when they hold government power.[23] The effects of government partisanship will manifest themselves primarily in terms of redistribution via government taxation and spending, but government policies also affect the distribution of market incomes in general and of wages in particular. Indirectly, government policies affect the distribution of wages via their effects on unemployment, the size of the public sector, and union density. More directly, governments influence the distribution

[20] OECD, "Trends in Trade-Union Membership," *Employment Outlook* (July 1991), 113.

[21] Focusing on wage restraint rather than wage distribution, Geoffrey Garrett and Christopher Way present similar arguments about the distinctive dynamics of public sector bargaining; see Garrett and Way, "Public Sector Unions, Corporatism and Wage Determination," in Iversen, Pontusson, and Soskice (fn. 5).

[22] Drawing on microdata for the early 1990s from the Luxembourg Income Survey, Gornick and Jacobs report very sizable public sector wage premiums for men and women alike in Belgium, Canada, Germany, the Netherlands, the U.K., and the U.S., but not in Sweden. See Janet Gornick and Jerry Jacobs, *Gender, the Welfare State and Public Employment*, Luxembourg Income Study Working Paper no. 168 (1997).

[23] Cf., e.g., Garrett (fn. 3).

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of wages through minimum-wage and equal-pay legislation, other forms of income policy, and a variety of measures that strengthen the competitive position of women and other disadvantaged groups (for example, immigrants) in the labor market. Partly for lack of good quantitative measures of such policies, we test the partisanship hypothesis by including Cusack's index of the cabinet center of gravity in our regressions.[24] As this index ranges between a score of 1 for a pure government of the radical left to a score of 5 for a pure government of the radical right, we expect the index values to be positively associated with wage inequality.

III. The Twist: Varieties of Capitalism

As indicated at the outset, this article explores whether the idea that the advanced capitalist countries form clusters with distinctive causal dynamics is applicable to the problem of explaining wage inequality. The typology of advanced capitalist countries used here hinges on the distinction between social market economies (SMEs) and liberal market economies (LMEs). The Northern European countries referred to as "social market economies" are essentially the same as the countries Katzenstein refers to as "corporatist," but the substantive connotations of the SME concept are different from those of the corporatism concept.[25] Katzenstein's well-known definition of corporatism emphasizes the formation of government policy through bargaining among centralized interest groups and the ideology of social partnership. Following Soskice, our conceptualization focuses more directly on the regulation of markets (government outputs rather than inputs).[26] However, our distinction between social and liberal market economies is narrower than Soskice's distinction between coordinated and liberal market economies and therefore yields a somewhat different grouping of countries.

Three basic features distinguish social market economies from liberal market economies. First, social market economies are characterized by comprehensive, publicly funded social welfare systems. Though the degree of redistribution varies, public welfare programs provide a relatively high "reservation wage" for the jobless and reduce workers' dependence on particular employers by providing for portability of employment benefits, retraining opportunities, sick pay insurance, and parental leave insurance. Using Esping-Andersen's terminology, we

[24] Tom Cusack, "Partisan Politics and Public Finance," *Public Choice* 91, no. 3–4 (1997).

[25] Katzenstein (fn. 2); and idem, *Policy and Politics in West Germany* (Philadelphia: Temple University Press, 1987).

[26] E.g., Soskice (fn. 2, 1990 and 1999).

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might say that all these countries have reached a critical threshold of labor decommodification via the public provision of social welfare.[27]

Second, social market economies are characterized by government regulation to standardize employment conditions and to provide for a high degree of employment security. The details of such labor-market regulation vary from one country to another, but the effects are broadly similar: increased costs for employers to shed labor and greater standardization of employment conditions across sectors and categories of labor. While pay scales may be more or less compressed, overt pay discrimination based on gender, race, or legal status (in the case of immigrants) is less common in social market economies than in liberal market economies. The employment conditions of full-time and part-time employees are also more alike.

Third, social market economies are distinguished by a high degree of institutionalization of collective bargaining and coordination of wage formation. By coordination of wage formation, we mean that wage developments in different sectors of the economy are more tightly coupled than they are in liberal market economies. As suggested by the Japanese case, employers may be able to coordinate the wage-formation process by themselves under certain circumstances: what is distinctive about the social market economies is that coordination occurs through collective bargaining, which gives unions a central role in the process.

While the public provision of welfare and government regulation of employment conditions clearly introduce new considerations into our analysis, the institutionalization of collective bargaining may appear to be nothing but the sum of union density and wage-bargaining centralization. These variables are undoubtedly correlated on a cross-national basis, but they are conceptually distinct. Union density pertains to the balance of power between unions and employers, centralization pertains to the formal organization of the wage-bargaining process, and institutionalization describes the influence of collectively bargained wages on actual wages across the whole economy. Estimated by recent OECD studies, the percentage of the labor force covered by collective bargaining agreements provides a rough and ready measure of institutionalization. Controlling for union density, coverage rates tell us about the extent to which nonunion workers are affected by the employment terms achieved by unions through collective bargaining.[28]

[27] Esping-Andersen (fn. 2).

[28] Collective bargaining coverage rates exceed union density either because governments decide to extend negotiated agreements to firms or sectors that were not party to the agreements (the French case) or because employers are better organized than unions and collective agreements encompass all employees of the firms that are party to the agreement (the German case).

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TABLE 2
FEATURES DISTINGUISHING SOCIAL AND LIBERAL MARKET ECONOMIES
(INDEX SCORES OR PERCENTAGES WITH OVERALL RANKS IN PARENTHESES)

	Welfare State		*Collective-Bargaining*	*Employment Protection*
Country	*Decom 1980*	*Spend/GDP 1990*	*Coverage 1990*	*1989*
SMEs				
Austria	31.1 (6)	23.9 (8)	98 (1)	9.0 (7)
Belgium	32.4 (5)	26.6 (5)	90 (4)	10.5 (3)
Denmark	38.1 (3)	28.3 (3)	69 (11)	3.3 (11)
Finland	29.2 (8)	25.3 (7)	95 (2)	10.5 (3)
Germany	27.7 (9)	23.8 (9)	90 (4)	12.0 (2)
Netherlands	32.4 (4)	28.8 (2)	71 (10)	7.3 (9)
Norway	38.3 (2)	26.9 (4)	75 (9)	9.8 (5)
Sweden	39.1 (1)	32.6 (1)	83 (6)	8.5 (8)
SME average	33.5	27.0	83.9	8.9
LMEs				
Australia	13.0 (16)	13.1 (15)	80 (8)	3.3 (11)
Canada	22.0 (14)	18.0 (12)	38 (14)	1.7 (15)
Japan	27.1 (11)	12.4 (16)	23 (15)	3.7 (10)
Switzerland	29.8 (7)	17.4 (13)	50 (12)	1.8 (14)
UK	23.4 (13)	19.8 (11)	47 (13)	2.3 (13)
USA	13.8 (15)	14.2 (14)	18 (16)	0.4 (16)
LME average	21.5	15.8	42.7	2.2
MIXED				
France	27.5 (11)	26.0 (6)	92 (3)	9.5 (6)
Italy	24.1 (12)	23.0 (10)	82 (7)	14.3 (1)

SOURCES: Decommodification index: Esping-Andersen (fn. 2), 52; total social spending as a percentage of GDP: OECD, *New Directions in Social Policy in OECD Countries* (Paris: OECD, 1994); and idem, *Social Expenditure Statistics in OECD Member Countries,* Labour Market and Social Policy Occasional Papers, no. 17 (1996); collective bargaining coverage rates: OECD (fn. 14), 71; employment protection index: OECD, *The OECD Jobs Study: Evidence and Explanations*, pt. 2 (Paris: OECD, 1994), 74.

Table 2 provides quantitative indicators of the three features that distinguish SMEs from LMEs for our sixteen countries. These figures are meant to be illustrative: in our conceptualization the distinction between social and liberal market economies is a categorical one and cannot be derived simply from the sum of these measures. To be categorized as a social market economy, moreover, a country must partake of all three features of "SME-ness."

Drawing on the typologies of other scholars, as well as on the data presented in Table 2, the majority of our countries are easily categorized as either SMEs or LMEs. France and Italy are the exceptions. Thus, al-

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though Italy's welfare state is smaller and less decommodifying than the countries we categorize as SMEs, it has the strictest employment protection legislation of all the countries included in our analysis, and its level of collective-bargaining coverage exceeds that of several SMEs. Ranking sixth in terms of social spending as a percentage of GDP, France would seem to have an even better claim to be coded as an SME. In view of the disorganized and fragmented character of French industrial relations, however, we do not believe that collective-bargaining coverage represents a meaningful measure of institutionalization in the French case.[29] While Italy lacks the welfare-state characteristics associated with SME-ness, France falls short when it comes to the institutionalization of collective bargaining. Nevertheless, it would surely be misleading to categorize these countries as liberal market economies. Following Hall, therefore, we resolve this problem by creating a separate category—"mixed economies"—for France and Italy.[30]

The typology presented in Table 2 diverges most clearly from conventional wisdom in its assignment of Japan and Switzerland to the category of liberal market economies. With respect to Japan, the reader must keep in mind that the criteria underlying our typology pertain specifically to government regulation of labor markets and/or joint regulation by employers and unions. Unquestionably, the Japanese case fails to conform to the model of a liberal market economy in matters of finance, corporate governance, and industrial policy. As for Switzerland, its score on Esping-Andersen's decommodification index falls well within the range of the social market economies, but on our other three indicators it clearly falls within the range of the liberal market economies.[31]

Table 3 summarizes how we expect the distinction between social and liberal market economies to affect the causal relationships hypothesized in the previous section. In general, we expect SME conditions to mute or neutralize the inegalitarian impact of market forces, measured here by unemployment, LDC trade, and female labor-force participation. The argument about unemployment is perhaps the most obvious one: if laid-off workers receive generous unemployment compensation and other welfare benefits, an increase in unemployment is less likely to

[29] The coverage rates estimated by the OECD do not necessarily pertain to wage agreements. A government decision to extend a collective agreement on summer holidays could account for France's exceptionally high coverage rate.

[30] Peter Hall, "Organized Market Economics and Unemployment in Europe" (Manuscript, Center for European Studies, Harvard University, 1998).

[31] As we explain in the conclusion, the question of how to code Japan and Switzerland turns out to be of no consequence for our main findings.

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TABLE 3
SUMMARY OF EXPECTED ASSOCIATIONS WITH WAGE INEQUALITY, TAKING SME/LME INTERACTIONS INTO ACCOUNT

Variable	*SMEs*	*LMEs*
Unemployment	− / 0	0 / +
LDC trade	0 / +	+
Female labor-force participation	0	+
Union density	−	−
Bargaining centralization	−	− / 0
Government employment	−	0
Government partisanship		
hypothesis 1	0	+
hypothesis 2	−	0

exert downward pressure on wages at the lower end of the wage hierarchy. With respect to LDC trade, we proceed from the proposition that LMEs are more segmented than SMEs. In a segmented economy, an increase of LDC imports will put downward pressure on the wages of the workers who produce the goods that are exposed to new competition from low-wage producers. In a more closely integrated or coordinated economy, we expect low-wage competition to translate into cuts in real wages for all workers, rather than into increased wage inequality. Finally, SME conditions are likely to alter the wage-distributive consequences of female labor-force participation, because women tend to be less skilled than men and often end up in precarious forms of employment for other reasons as well (most obviously child-rearing responsibilities). Outside the public sector, feminization of the workforce typically correlates with low levels of unionization. As noted above, the institutional arrangements that distinguish SMEs from non-SMEs serve to standardize employment conditions and provide for the extension of union-negotiated wage contracts to nonunion members. This should mitigate the inegalitarian effects of an increase of female labor-force participation.

Turning to the political-institutional variables that constitute our primary interest, the institutional arrangements characteristic of SMEs enhance the significance of collective bargaining relative to market forces and, as a result, the characteristics of collective bargaining should matter more to wage-distributive outcomes. In SMEs, where reservation wages are high and bargaining coverage is extensive, the equalizing effect of bargaining centralization should be especially large.

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The implications of SME conditions for the wage-distributive impact of unionization are less straightforward. On the one hand, one might suppose that those aspects of social market economies that enhance employment security would serve to desensitize unions and their members to the potential employment costs of wage compression and therefore render them more prone to pursue (support) egalitarian wage demands. By this logic, a one-unit increase in unionization should be associated with a larger reduction of wage inequality in SMEs than in LMEs. On the other hand, the extension of union-negotiated wage contracts to nonunion workers would seem to imply that levels of wage inequality in SMEs are less sensitive to changes in union density than they are in LMEs. As indicated in Table 3, our prior assumption is that these countervailing effects cancel each other out and that the wage-distributive effects of union density are not affected by the SME-LME distinction.

With respect to government employment, we expect that its egalitarian impact will be greatest under SME conditions. In both types of economies, private sector employers who compete with public sector employers for labor at the lower end of the labor market must follow suit if public sector employers raise the relative wages of the lowest paid employees. By linking wage developments in different sectors more closely, the institutional arrangements characteristic of SMEs should expand the spillover of public sector wage compression into the private sectors.

Finally, there are two competing ways to think about the interaction between social market conditions and government partisanship. On the one hand, SME arrangements might be conceived as constraints that limit the effects of partisanship (or ideology) on government policy. On the other hand, governments would seem to be significantly more involved in wage formation in SMEs than in non-SMEs, and therefore the preferences of governing parties may have more important consequences for wage formation. According to the latter perspective, the association between leftist government and wage compression should be stronger in SMEs than in non-SMEs; according to the former perspective, it should be weaker.

IV. Methodology

In pooled cross-section time-series analysis, "country-years" are the units of observation of dependent and independent variables. By incorporating over-time variations, pooling dramatically increases the total number of observations and enables us to test more complex causal

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models against data from a relatively small number of countries. At the same time this methodology is inextricably linked to the idea that cross-national variations and changes over time have common determinants; more precisely, it is linked to the goal of ascertaining the common determinants of cross-national variations and changes over time.

We address the autocorrelation problem associated with time-series data by including the lagged dependent variable on the right-hand side of the equation. Following Beck and Katz, we include a lagged dependent variable because it "makes it easier . . . to examine dynamics and allows for natural generalizations in a manner that the serially correlated errors approach does not."[32] As the distribution of wages changes only marginally from one year to the next, the coefficient for levels of wage inequality in the previous year turns out to be highly significant. On the assumption that the effects of a one-unit change in a particular variable persist, the long-term effects of such a change can be computed by dividing the value of the coefficient for the variable of interest by 1 minus the coefficient for the lagged dependent variable.[33] In what follows, we estimate both long-term and immediate effects for each variable.

Our regression models also include dummy variables for each of the countries in our data set. We do this to eliminate the bias resulting from the effects of country-specific omitted variables.[34] Put somewhat crudely, the country dummies control for the values that all observations for a given country share. While we are not interested in why particular countries fit our regression more or less closely and therefore do not report the coefficient estimates for the country dummies below, we believe that it is essential to control for country-specific effects in this manner. Scholars engaged in cross-national comparison sometimes eschew the use of country dummies on the grounds that they simply tell us that countries are different, when the interesting question is how or why they are different. Yet there is every reason to suspect that outcomes such as ours are influenced by country-specific historical or cultural factors, which cannot be measured on a cross-national basis (for instance, the influence of milltown culture on the priority assigned to wage solidarity by the Swedish labor movement). The results of F-tests

[32] Nathaniel Beck and Jonathan Katz, "Nuisance vs. Substance," in John Freeman, ed., *Political Analysis* (Ann Arbor: University of Michigan Press, 1996), 6:1. The results of Breusch-Godfrey tests indicate that there is no significant autocorrelation in our regressions. In tests with a variety of lags, we could not reject the null hypothesis (nonexistence of autocorrelation) at a level even close to the 90 percent traditional significance threshold. See William Greene, *Econometric Analysis* (Englewood Cliffs, N.J.: Prentice Hall, 1997), 595.

[33] Cf. George Box and Gwilyn Jenkins, *Time Series Analysis* (Oakland, Calif.: Holden-Day, 1976), chap. 1.

[34] See Cheng Hsiao, *Analysis of Panel Data* (New York: Cambridge University Press, 1986).

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strongly confirm that country dummies belong in the specification of our regression models.[35]

Nickell demonstrates that, with short panel data, OLS estimation of models with lagged dependent variables and fixed effects produces biased coefficients.[36] We address this problem by computing the instrumental variable (IV) estimator suggested by Anderson and Hsiao and using a two-stage IV procedure.[37]

In what follows, we present first the results of a linear regression model and then the results of a model in which our independent variables are interacted with dummy variables for social market economies (SME), liberal market economies (LME), and mixed economies (MIX). We use the independent variables, a one-year lag of the independent variables, and the country dummies as the instruments and treat the lagged dependent variable as endogenous.[38] For the linear model we estimate the following equation:

$$y_{it} = \chi \hat{y}_{i,t-1} + \sum_{k} \beta_k x_{kit} + \alpha_i + \varepsilon_{it} \qquad (1)$$

Where y_{it} is the dependent variable, the x's are the independent variables, i refers to the cross-sectional units, t to the time units, k to the number of independent variables, α_i refers to the separate intercepts for each country (there is no common intercept), β_k refers to the slopes of the explanatory variables, χ to the slope of the lagged dependent variable predicted in the first stage of the IV procedure, and ε_{it} is a random error term normally distributed around a mean of 0 with a variance of σ^2.

The setup of our interaction model is the same except that we introduce three additional dummy variables (SME, LME, and MIX), which we interact with the x variables. Again we use the independent variables, a one-year lag of the independent variables and the country dummies as the instruments and treat the lagged dependent variable as endogenous. We estimate the following equation:

[35] For the regressions reported in Tables 2 and 3 the results of F-tests show that the country dummies are significant at better than the 99 percent level.

[36] Stephen Nickell, "Biases in Dynamic Models with Fixed Effects," *Econometrica* 49 (November 1981).

[37] See T. W. Anderson and Cheng Hsiao, "Estimation of Dynamic Models with Error Components," *Journal of the American Statistical Association* 76 (September 1981); and idem, "Formulation and Estimation of Dynamic Models Using Panel Data," *Journal of Econometrics* 18 (January 1982). This is similar to the method suggested by Hibbs and employed by Alvarez, Garrett, and Lange. See Douglas Hibbs, "Problems of Statistical Estimation and Causal Inference in Dynamic Time Series Models," in Herbert Costner, ed., *Sociological Methodology 1973/1974* (San Francisco: Jossey-Bass, 1974); and Michael Alvarez, Geoffrey Garrett, and Peter Lange, "Government Partisanship, Labor Organization and Macroeconomic Performance," *American Political Science Review* 85 (June 1991).

[38] In both the linear and the interaction models, the instruments we use turn out to be excellent predictors of the lagged dependent variable. The R^2 obtained in the first-stage IV regressions was higher than .95.

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$$y_{it} = \gamma \hat{y}_{i,t-1} + \sum_k \lambda_k * x_{kit} * \text{SME} + \sum_k \omega_k * x_{kit} * \text{LME} + \sum_k \delta_k * x_{kit} * \text{MIX} + \tau_i + \eta_{it} \quad (2)$$

where τ_i refers to the separate intercepts for each country (there is no common intercept), λ_k, ω_k, and δ_k refer to the slopes of the explanatory variables, γ to the slope of the lagged dependent variable predicted in the first stage of the IV procedure, and η_{it} is a random error term normally distributed around a mean of 0 with a variance of σ^2.[39]

For each x variable, this equation yields separate coefficient estimates for the countries we have coded as social market economies, liberal market economies, and mixed cases. The same coefficient estimates would be obtained if the linear model were run separately for each set of countries, but the results of our interaction model are more directly comparable to the results of our linear model, since the total number of observations is the same in the two models.

Two other features of our analysis should be noted before we turn to the empirical results. First, the analysis includes interpolated observations of wage inequality for some of the years with missing observations in Figures 1 and 2. Observations for missing years were interpolated on the assumption that any change between two years was evenly distributed across the intervening years, but we decided not to interpolate data across more than three missing years. The analysis therefore uses only 20 interpolated observations out of a total of 217.[40] Second, we engaged in logarithmic transformations of all variables other than the dummy variables before running the regressions. When variables on both sides of the regression equation are logged, the regression coefficients can be interpreted as measuring the percentage change in the dependent variable associated with a percentage change in the independent variable. The slope values yielded by our regressions thus represent elasticity measures of the relationship between the variables.

[39] Nathaniel Beck and Jonathan Katz propose a method for deriving consistent standard error estimates in the presence of panel-heteroscedastic errors that has been widely adopted by students of comparative political economy, e.g., Garrett (fn. 3); and Iversen (fn. 3); see Beck and Katz, "What to Do (and Not to Do) with Time-Series Cross-Section Data," *American Political Science Review* 89 (September 1995). When we ran our regressions with the Beck-Katz procedure (estimating panel-corrected standard errors without instrumental variables), we obtained results that were essentially the same as those reported below (available upon request). None of our substantive findings are affected by the choice of one or the other of these setups.

[40] In terms of overall numbers, the interpolations make up for the loss of observations entailed by the use of a lagged dependent variable. More importantly, interpolation enables us to include Norway in our analysis.

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V. Empirical Results

Table 4 reports the results of the linear regression model specified above and Table 5 reports the results of our interaction model. Table 6 pertains to the results of the interaction model, specifically, whether or not the observed differences between SMEs and LMEs are statistically significant.

Let us consider first the results of the linear model. While all four of the political-institutional variables in our analysis turn out to have a statistically significant association with levels of wage inequality, this is true for only one of the three variables intended to capture supply-and-demand conditions. The countervailing effects of unemployment, putting downward pressure on the wages of the unskilled workers but also removing a disproportionate number of unskilled workers from the employed labor force, apparently cancel each other out. As for LDC trade, the empirical results simply do not bear out our expectation that this variable would be positively associated with wage inequality. By contrast, female labor-force participation does have a sizable, positive coefficient, which readily clears conventional thresholds of statistical significance. This finding supports the hypothesis that increased female labor-force participation typically entails an increase in the relative supply of unskilled labor. As expected, union density, bargaining centralization, and government employment are associated with less wage inequality in the model, whereas rightist government is associated with more wage inequality. The size of the long-term coefficients for all these variables is considerable.

Setting aside the question of substantive significance for the time being, the results of our interaction model indicate that the determinants of wage inequality do indeed differ across clusters of advanced capitalist economies. Some of the generalizations supported by Table 4 appear quite misleading in view of the results reported in Table 5. To begin with, none of the variables in our analysis has statistically significant effects on the distribution of wages in the two countries we code as mixed cases (France and Italy). Thus we can concentrate on the theoretically interesting question of the differences between SMEs and LMEs.

Comparing SMEs with LMEs, we find that unemployment and LDC trade are equally irrelevant to wage-distributive outcomes while union density has a strong egalitarian impact in both sets of countries. More clearly than in the linear model, union density here emerges as the single most important variable explaining the observed variance of wage inequality in our data set. For the remaining four variables, we observe statistically significant differences between SMEs and LMEs (compare Table 6).

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TABLE 4
THE DETERMINANTS OF WAGE INEQUALITY IN 16 COUNTRIES (1973–95)

Variable	*Coefficients and Standard Errors*	*P-values*	*Long-Run Effects*
Lagged dependent variable	.499	<.001	—
	(.153)		
Unemployment	−.002	.386	−.004
	(.005)		
LDC trade	.0004	.484	.0008
	(.009)		
Female labor-force participation	.094	.012	.188
	(.041)		
Union density	−.037	.020	−.074
	(.018)		
Bargaining centralization	−.048	.006	−.096
	(.019)		
Government employment	−.099	.009	−.198
	(.042)		
Government partisanship	.022	.001	.044
	(.007)		

All entries are two-stage least squares estimates. P-values are one-sided. N = 217.

The coefficient for bargaining centralization is negative in both LMEs and SMEs, but the egalitarian impact of centralization is more than three times as great in SMEs according to these results. Indeed, the centralization coefficient for LMEs fails to clear the 90 percent level of statistical significance. On this count, our results diverge sharply from Wallerstein's. Whereas he writes that "it is difficult to find other variables that matter once the institutional variation in wage-setting is controlled for,"[41] we find not only that other political-institutional variables matter but also that the egalitarian effects of centralization are largely, if not entirely, contingent on SME conditions.[42]

The differences between SMEs and LMEs are more striking still with respect to the wage-distributive effects of female labor-force participation, government employment, and government partisanship, for the signs of the coefficients of these variables actually differ in the two sets of countries. According to our interaction model, the inegalitarian effects of female labor-force participation occur only under LME condi-

[41] Wallerstein (fn. 1), 650.

[42] Our analysis is based on a much larger number of observations and covers a longer time period than Wallerstein's. Different measures of bargaining centralization constitute another potential source of divergent results.

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TABLE 5
THE DETERMINANTS OF WAGE INEQUALITY IN SOCIAL MARKET, LIBERAL MARKET, AND MIXED ECONOMIES (1973–95)

	Social Market Economies			*Liberal Market Economies*			*Mixed Economies*		
Variables	*Coeffic. and Standard Errors*	*P-values*	*Long-Run Effects*	*Coeffic. and Standard Errors*	*P-values*	*Long-Run Effects*	*Coeffic. and Standard Errors*	*P-values*	*Long-Run Effects*
Lagged dependent variable	.495 (.144)	*<.001*							
Unemployment	−.0004 (.006)	*.475*	−.0008	−.002 (.014)	*.433*	−.004	−.006 (.084)	*.472*	−.012
LDC trade	−.003 (.010)	*.368*	−.006	.013 (.015)	*.192*	.026	−.005 (.033)	*.442*	−.010
Female labor-force participation	−.059 (.071)	*.202*	−.117	.229 (.106)	*.016*	.453	−.374 (.641)	*.280*	−.741
Union density	−.114 (.048)	*.009*	−.226	−.119 (.046)	*.006*	−.236	−.060 (.105)	*.284*	−.119
Bargaining centralization	−.085 (.023)	*<.001*	−.168	−.024 (.021)	*.126*	−.048	−.024 (.051)	*.318*	−.048
Government employment	−.082 (.046)	*.040*	−.162	.104 (.052)	*.024*	.206	.006 (.508)	*.495*	.012
Government partisanship	−.005 (.011)	*.321*	−.010	.033 (.011)	*.002*	.065	.012 (.023)	*.305*	.024

All entries are two-stage least squares estimates. P-values are one-sided. N = 217.

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TABLE 6
TESTS FOR EQUALITY OF COEFFICIENTS IN SMES AND LMES

Variable	*P-Value*
Unemployment	.898
LDC trade	.360
Female labor-force participation	.042
Union density	.934
Bargaining centralization	.005
Government employment	.018
Government partisanship	.015

P-values are for F-tests for the equality of the coefficients in SMEs and LMEs.

tions. The argument that social market conditions cushion the inegalitarian impact of the entry of new categories of unskilled labor into the workforce by extending union-negotiated wage contracts to nonunion workers provides a reasonable explanation of the absence of inegalitarian effects in the SMEs. However, this argument does not explain why female labor-force participation appears to be associated with less wage inequality in the social market economies of Western Europe, though the association is not quite significant by conventional criteria.

At least in part, the negative coefficient for female labor-force participation under social market conditions reflects the fact that the Scandinavian SMEs are characterized by higher rates of female participation as well as more compressed wages than are their continental counterparts. Arguably, the negative association between these variables is spurious, with female labor-force participation serving as a proxy for a complex of government policies that strengthens the position of women in the labor market and thereby reduces wage differentials between men and women. In other words, we might be picking up the effects of Scandinavian welfare states being more women friendly than the welfare states of continental Europe. But the negative association between female labor-force participation and wage inequality in SMEs might also be related to differences in the timing of increases in female labor-force participation. As noted earlier, the effects of female labor-force participation are likely to become egalitarian over time, as women acquire experience and skills at their jobs and as their position in the labor market becomes less precarious. As a group, the SMEs are more bifurcated on this score than the LMEs. Thus, the Scandinavian countries experienced a sharp increase of female labor-free participation as early as the 1960s, while female participation in the continental SMEs remained below the OECD average in the 1990s.

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The results for government employment are similar to the results for female labor-force participation. In this case, the egalitarian effects observed in the linear regression model occur only among the SMEs. For the LMEs, the coefficient for government employment is positive—and statistically significant. The distinctively egalitarian dynamics of public sector wage bargaining appear to be contingent on SME conditions. Along the lines suggested above, our results are also consistent with the propositions that public sector wage premiums typically have inegalitarian effects and that the coordinated wage bargaining characteristic of social market economies curtail the scope of public sector wage premiums.

Finally, the results of our interaction model strongly support the hypothesis that SME conditions constrain the effects of government partisanship. In liberal market economies rightist government is associated with more wage inequality at a high level of statistical significance. In social market economies, by contrast, the association between these variables is far from significant.

The substantive significance of these findings is perhaps best illustrated by simulating the effects of a change in one or several of the statistically significant variables for a specific country. If we change the value of a particular variable to that of a country with more wage inequality, the simulated effect of this change can be compared with the actual difference in wage inequality between the two countries. Table 7 reports the results of simulations that assign German values to Sweden, using data for 1990 and the regression coefficients yielded by our interaction model. These two countries were chosen because Sweden, with a 90–10 ratio of 2.01 in 1990, stands out as the social market economy with the most compressed wage distribution, while Germany, with a 90–10 ratio of 2.72 in 1990, falls at the other end of the SME spectrum on our dependent variable.[43]

The first row of Table 7 contains our estimate of how the Swedish 90–10 ratio would have changed had Swedish union density suddenly dropped to the German level in 1990, with the values of all other variables remaining constant. Our regression results imply that such a change would have translated into a 24 percent increase of Swedish wage inequality over a ten-year period. In the second and third rows we report the results of repeating this exercise for the other two variables that proved to have a statistically significant association with wage inequality in SMEs, bargaining centralization, and government employ-

[43] In Figures 1 and 2 Austria has an even more dispersed wage distribution than Germany, but the fact that the Austrian wage data include part-time employees makes the Sweden-Germany comparison more appropriate.

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TABLE 7
SIMULATED EFFECTS OF ASSIGNING GERMAN VALUES TO SWEDEN
(ACTUAL 90-10 RATIO IN 1990: 2.01)

			Simulation	
Variable[a]	*Swedish Level, 1990*	*German Level, 1990*	*90-10 Ratio after 10 Years*	*% Change in Wage Inequality*
Union density	84.0	32.9	2.48	+24
Bargaining centralization	.456	.318	2.13	+6
Government employment	31.6	15.1	2.26	+13
All 3 variables			2.97	+48

[a] When all three variables are changed at once, the total effect is realized in nine years, with the bulk of the effect realized in five years (90–10 ratio of 2.94 after five years).

ment. The fourth row, finally, contains our estimate of how Swedish wage inequality would have changed had all three variables taken on German values in 1990 (still holding all other variables in our analysis constant). When we change all three variables at once, Sweden's 90–10 ratio increases by 48 percent.

Similarly, Table 8 reports the results of simulations based on assigning U.S. values to Australia. As with Sweden and Germany, these countries were chosen because they represent opposite ends on the LME spectrum on our dependent variable. In 1990 the 90–10 ratio for Australia was 2.84, as compared with 4.33 for the U.S. Among LMEs there are four variables that have a statistically significant association with wage inequality: female labor-force participation, union density, government employment, and partisanship. Interpreting the results in Table 8 is complicated by the fact that as a pair Australia and the U.S. do not conform to our finding that there exists a positive relationship between the size of the public sector and wage inequality in LMEs. Assigning U.S. values to Australia on this variable actually reduces wage inequality in Australia (and increases the wage inequality gap between Australia and the U.S.). Nonetheless, changing the values of all four variables at once yields a 28 percent increase in wage inequality in Australia.

In a slightly different vein the British experience of the 1980s provides a convenient real-world illustration of the substantive significance of our estimates of the wage-distributive effects of government partisanship in liberal market economies. When the Conservatives took over the reins of government from the Labor Party in 1979, govern-

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TABLE 8
SIMULATED EFFECTS OF ASSIGNING U.S. VALUES TO AUSTRALIA
(ACTUAL 90–10 RATIO IN 1990: 2.84)

			Simulation	
Variable[a]	*Australian Level, 1990*	*U.S. Level, 1990*	*90–10 Ratio after 10 Years*	*% Change in Wage Inequality*
Female labor-force participation	41.3	44.9	2.95	+4
Union density	46.6	15.6	3.68	+29
Government employment	23.0	14.6	2.59	−9
Government partisanship	2	4	2.97	+5
All 4 variables			3.64	+28

[a] When all four variables are changed at once, the total effect is realized in ten years, with the bulk of the effect realized in five years (90–10 ratio of 3.61 after five years).

ment partisanship, as measured by Cusack's index, increased by 100 percent (from 2 to 4). The results of our interaction model imply that the results of this enduring change raised the British 90–10 ratio by about 5 percent (from 2.95 to 3.09) over the subsequent decade, but in fact, the British 90–10 ratio increased by 15.6 percent from 1979 to 1990. In a loose sense, our regression results thus suggest that almost one-third of the increase of British wage inequality might be attributed to Conservative government policies.

VI. CONCLUSION

While our analysis provides no support whatsoever for the contention that unemployment is a source of wage inequality or for the contention that trade with low-wage countries is a source of wage inequality, it lends some support to the hypothesis that female labor-force participation promotes wage inequality by increasing the relative supply of unskilled labor. However, this hypothesis holds only for countries characterized as liberal market economies. Should we conclude, then, that supply-and-demand conditions are largely irrelevant to the evolution of wage inequality in advanced capitalist economies? Our results certainly do not warrant such a far-reaching conclusion, which flies in the face of a great deal of empirical work (as well as theorizing) by labor economists. Variables such as the aggregate unemployment rate and

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LDC trade as a percentage of GDP are probably too crude to capture the impact of market forces. At most, our analysis suggests that the wage-distributive effects of such variables are less straightforward than commonly supposed and that we should be wary of exaggerating their significance. In particular, the wage-distributive effects of trade with low-wage countries are likely smaller than suggested by some scholars (notably Wood) and by many media commentaries.[44]

Our findings concerning the role of political-institutional variables are less tentative and also more interesting. We have identified several discrete variables that fall under this general heading and we have shown that it is possible to obtain statistically significant results for all these variables in a pooled regression framework. We have shown furthermore that the distinction between social and liberal market economies has important implications for our understanding of the determinants of wage inequality. As with female-labor force participation, the wage-distributive effects of bargaining centralization, government employment, and partisanship differ across varieties of capitalism. Only one of the variables in our analysis, union density, has a significant association with wage inequality that is unaffected by the distinction between SMEs and LMEs.

The finding that the effects of partisanship are contingent on broad institutional constellations should be of particular interest to political scientists. Students of comparative politics have long argued over whether or not—or to what extent—the partisan composition of government matters to real economic and social outcomes, with the skeptics emphasizing that governments are constrained by some combination of political-institutional arrangements, structural economic conditions (specifically, the critical importance of private investment), and the preferences of the median voter. In recent literature on the evolution of government spending and social policy in advanced capitalist countries, this debate has been recast as a debate over whether or not partisanship still matters. While Pierson and Stephens, Huber, and Ray argue that partisan effects on spending have diminished since the 1970s, Garrett finds that these effects have actually become more pronounced in the era of globalization.[45]

[44] Wood (fn. 8). The more fine-grained analysis by Vincent Mahler, David Jesuit, and Douglas Roscoe also fails to establish any clear and consistent pattern of association between wage inequality and various dimensions of "globalization." See Mahler, Jesuit, and Roscoe, "Exploring the Impact of Trade and Investment on Income Inequality," *Comparative Political Studies* 32 (May 1999).

[45] Garrett (fn. 3); Paul Pierson, "The New Politics of the Welfare State," *World Politics* 48 (January 1996); John Stephens, Evelyne Huber, and Leonard Ray, "The Welfare State in Hard Times," in Kitschelt et al. (fn. 2); and Garrett (fn. 3).

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Our analysis suggests that it may be useful to introduce the varieties-of-capitalism idea into the debate about partisanship: the extent to which partisanship matters and the extent to which partisan effects have changed over time may depend on how the political economy (as a whole) is organized. This said, we hasten to point out that the interaction effect we have established here pertains specifically to the determinants of wage inequality. The fact that partisanship matters to the distribution of wages in LMEs but not in SMEs reflects the broad scope of institutionalized wage bargaining and the concomitant absence (or insignificance) of minimum wage legislation and other forms of direct government regulation of wages in SMEs. It does not follow from this finding that the effects of partisanship in the realms of social policy or macroeconomic management are smaller in SMEs than in LMEs. Further research and analysis are clearly necessary to determine the broader implications of the varieties-of-capitalism approach for quantitative comparative political economy.

Needless to say, the results of our interaction model depend on our prior coding of countries as SMEs, LMEs, and MIXs. Most obviously, the decision to code Japan and Switzerland as liberal market economies might be questioned. By the criteria set out above, Japan and Switzerland certainly cannot be categorized as social market economies, but perhaps they should be categorized as mixed cases rather than liberal market economies. Focusing on public or collective regulation of labor markets, the picture presented in Table 2 entirely misses the informal practice of lifetime employment by large Japanese companies, for instance. Rerunning our interaction model with Japan and Switzerland coded as mixed cases (along with France and Italy), the regression results obtained for the mixed cases were quite different, but the results for the SMEs and the LMEs were essentially the same as those reported above. For the SMEs and the LMEs, no variable became either significant or insignificant at the 90 percent confidence level and differences in coefficient estimates between the SMEs and the LMEs that were initially significant at the 90 percent level remained so when we recoded Japan and Switzerland.[46] Practically speaking, then, our conclusions do not depend on whether Japan and Switzerland are considered liberal market or mixed economies.

[46] Among the statistically significant variables, the single largest coefficient change we obtained was for government employment in LMEs: this coefficient fell from .104 to .086 when we recoded Japan and Switzerland. For the mixed cases, the coding change produced statistically significant coefficients for wage bargaining centralization (negative, as in SMEs), government employment (negative, as in SMEs) and government partisanship (positive, as in LMEs). Results available from the authors upon request.

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The time-invariant quality of the dummies we use to capture varieties of capitalism represents another potential pitfall. Perhaps recent changes in advanced capitalist political economies have rendered the SME-LME distinction less meaningful. Substantive knowledge of the country cases is the only real check on this problem. SMEs and LMEs alike underwent institutional changes during the time covered by our analysis (1973–95)—to some extent, captured by our union density and wage-bargaining centralization variables—but there is precious little evidence of generalized convergence between SMEs and LMEs and we simply cannot think of any country that can be said to have moved from the SME camp to the LME camp or vice versa.

More fundamentally, two alternative understandings of these clusters of advanced capitalist political economies should be noted here. Consider the matter in terms of our dummy variable for SMEs. On the one hand, this variable might be viewed as a proxy for a set of discrete variables—welfare-state decommodification, institutionalization of collective bargaining, and employment protection—for which we do not have year-to-year observations. Some of these variables may be difficult to measure, but in principle they are all measurable, and if we had observations for each of these variables, the SME dummy would be superfluous. On the other hand, we might think of the SME dummy as capturing the way that discrete variables are configured within a coherent whole, that is, as referring to an institutional context with emergent properties that cannot be reduced to discrete variables. Setting aside the specificities of the SME concept, the tension between these two perspectives animates current theoretical debates in comparative political economy. While we are inclined to take the idea of emergent properties seriously, we want to emphasize the empirical nature of the questions at stake in this debate. The most obvious way to determine whether varieties of capitalism are reducible to discrete variables is to try to achieve such a reduction.

Finally, the importance of union density as a determinant of wage inequality deserves to be underscored one more time. Across the SME-LME divide, the effects of union density are consistently egalitarian, and for each cluster of countries they are greater than those of any other independent variable in our analysis. This finding suggests that conflicts of interest between unions and employers constitute an important dimension of the politics of wage distribution. If wage-distributive outcomes were primarily an expression of employer preferences, as Swenson's revisionist account of the Swedish story of wage solidarity would have it, it would be difficult to make sense of the association between

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union density and wage compression.[47] On this score, the general implication of our analysis is that we should be wary of embracing a wholly employer-centered approach to comparative political economy.

In no way does our analysis deny that distributive conflict among wage earners also constitutes an important dimension of the politics of wage distribution. The empirical data at our disposal simply do not allow us to capture this dimension. To do so, we would need to be able to measure gender differences in union density or the distribution of union membership across the hierarchy of wages and skills. (By shifting the focus to intersectoral wage differentials, the sectoral distribution of union membership would also be of interest.) The labor force surveys from which such measures might be derived are becoming available, but only for recent years. They thus do not allow very sophisticated analyses using countries as the unit of observation. Tackling this methodological challenge is an important part of the research agenda that flows from the preceding analysis. In future research we also want to explore the interface between distributive labor-market outcomes and the redistributive effects of the welfare state.

Appendix: Data Sources

90–10 ratio. data provided by the OECD, Directorate for Education, Employment, Labour and Social Affairs.

Unemployment. OECD, *Historical Statistics* (electronic database).

LDC trade. For all countries but Belgium, data on LDC trade were provided by Geoffrey Garrett (Yale University); Belgian and post-1990 figures were calculated on the basis of OECD, *Monthly Statistics of Foreign Trade.*

Female labor-force participation. OECD, *Historical Statistics* (electronic database).

Government employment. OECD, *Historical Statistics* (electronic database).

Union density. The pre-1990 figures were taken from Jelle Visser, "Unionization Trends Revisited," Centre for Research of European Societies and Industrial Relations (Amsterdam, 1996); post-1990 figures were provided by Bernhard Ebbinghaus (Max-Planck Institute).

[47] Peter Swenson, *Labor Markets and Welfare States* (forthcoming).

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Centralization. The wage-bargaining centralization index was provided by Torben Iversen (Harvard University). For a complete specification, see Iversen (fn. 3).

Government partisanship. Figures were provided by Tom Cusack (Wissenschaftszentrum, Berlin). For details, see Cusack (fn. 24).

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Research Note

REASSESSING THE THREE WAVES OF DEMOCRATIZATION

By RENSKE DOORENSPLEET*

INTRODUCTION

SINCE the publication of Samuel Huntington's influential 1991 study of democratization,[1] scholars have come to take for granted the notion that the spread of democracy has come in waves, with bursts of progress being succeeded by quite substantial reversals—the result being a flow and ebb marking a less than optimistic two-step-forward, one-step-backward pattern. According to Huntington, there have in fact been three distinct waves of democratization, with a wave being defined as a group of transitions from nondemocratic to democratic regimes that occurs within a specified period of time and in which those transitions significantly outnumber transitions in the opposite direction.[2] This is far from a linear process, however, as waves of democratization have been followed by reverse waves in which some of the democratic countries reverted to nondemocratic rule, leaving fewer cases of consolidated democracies behind. According to Huntington, the first "long" wave flowed uninterruptedly from 1826 to 1926, marking the emergence of democratic regimes as a nineteenth-century phenomenon. Following a reverse wave, the end of World War II provided the impetus for the second, short wave of democratization. Thereafter came an enormous global swing away from democracy in the 1960s and early 1970s, which, in turn, was succeeded by a third wave of democratization, which took off in the years following the end of the Por-

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[1] Samuel P. Huntington, *The Third Wave: Democratization in the Late Twentieth Century* (Norman: University of Oklahoma Press, 1991).

[2] Ibid., 15.

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tuguese dictatorship in 1974.[3] Arguing from the vantage of the early 1990s, Huntington further contended that these waves have entailed a far from optimistic pattern of progress:

> The proportions of democratic states in the world show a considerable regularity. At the troughs of the two reverse waves 19.7 percent and 24.6 percent of the countries were democratic. At the peaks of the two democratization waves, 45.3 percent and 32.4 percent of the countries in the world were democratic. In 1990 roughly 45.4 percent of the independent countries of the world had democratic systems, the same percentage as in 1922. . . . [I]n 1990 the third wave of democratization still had not increased the proportion of democratic states in the world above its previous peak sixty-eight years earlier.[4]

Moreover, he also suggested that, at the time he was writing, there were possible signs of the beginnings of a third reverse wave, in that three third-wave democracies—that is, Haiti, Sudan, and Surinam—had quickly reverted to authoritarianism.[5]

Although Huntington's study has been very influential, I wish to suggest that his analysis is nevertheless far from compelling. There are two problems. The first is largely conceptual: the analysis fails to provide a clear and meaningful distinction between democratic and authoritarian regimes. To be sure, Huntington's definition of democracy adopts Dahl in specifying the three requirements of competition, inclusiveness, and civil liberties.[6] But in practice he focuses primarily on Dahl's dimension of competition and sometimes simply ignores the requirement of universal suffrage—that is, the equally important dimension of inclusion.[7] Thus, Huntington's eventual classifications are more ambiguous and inconsistent, as for instance when he classifies the

[3] By Schmitter's reckoning, there have been four, more compact waves. In addition to Huntington's second and third waves, he thinks there had occurred two other earlier waves; one spectacular but ephemeral wave began in 1848 and reverted in 1852, and the other major outbreak of democracy corresponded to World War I and its aftermath. See Philippe C. Schmitter, "Waves of Democratization," in Seymour Martin Lipset et al., eds., *Encyclopedia of Democracy*, vol. 2 (London: Routledge, 1995), 346–50.

[4] Huntington (fn. 1), 25–26.

[5] Ibid., 14–15.

[6] Robert A. Dahl, *Polyarchy, Participation and Opposition* (New Haven: Yale University Press, 1971); Huntington (fn. 1), 7.

[7] Huntington is not alone in this. Many other quantitative researchers focus almost exclusively on the degree of competition and make little or no reference to the extent to which the regimes in question are also inclusive. See, e.g., Kenneth A. Bollen, "Issues in the Comparative Measurement of Political Democracy," *American Sociological Review* 45 (June 1980); idem, "Liberal Democracy: Validity and Method Factors in Cross-National Measures," *American Journal of Political Science* 37 (October 1993); Raymond D. Gastil, "The Comparative Survey of Freedom: Experiences and Suggestions," in Alex Inkeles, ed., *On Measuring Democracy: Its Consequences and Concomitants* (New Brunswick, N.J.: Transaction Publishers, 1991); Keith Jaggers and Ted Robert Gurr, "Tracking Democracy's Third Wave with the Polity III Data," *Journal of Peace Research* 32 (1995); M. Alvarez et al., "Classifying Political Regimes," *Studies in International Comparative Development* 31 (Summer 1996).

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United States until 1965 and Switzerland until 1971 as undemocratic, while some pages later indicating that both were democratic a century earlier.[8] Moreover, he also appears to adopt other criteria for nineteenth-century systems, which are classified as having already become democratic when 50 percent of adult males become eligible to vote.[9] Finally, early-twentieth-century Portugal is also considered democratic, even though only male citizens had then won the right to participate.

The second problem, equally acute, is empirical. In brief, Huntington has estimated the incidence of transitions to democracy in terms of the *percentages* of world states involved. Since the denominator in this equation, that is, the number of states in the world, is far from constant, this measure can be misleading. As we shall see, for example, the number of (minimal) democracies in the world grew from thirty in 1957 to thirty-seven in 1972, thus appearing to reflect a small but noticeable "wave" of democratization. Considered as a percentage, by contrast, this same period seems to have been characterized by a small *reverse* wave, in that the proportion of states that were democratic fell from 32 percent to 27 percent. The explanation for this apparent paradox is simple: largely as a result of decolonization in Africa, the number of independent states in the world—the denominator—grew from 93 to 137; hence, although there was an absolute increase in the number of democratic regimes, their proportion of world states actually fell.

In the subsequent sections of this research note I offer solutions to both of these problems, first, by specifying a tighter and more consistent distinction between democratic and nondemocratic regimes, and second, by taking into account the actual numbers of states that made a transition from nondemocracy to democracy, or vice versa. I conclude by proposing a reassessment of the three waves of democracy that suggests that there has been a first and major wave of democratization lasting from the early 1890s to the mid-1920s. This is then followed by a minor reverse wave that continues through the early 1940s, after which the trend turns upward again, although not in so pronounced a fashion as that suggested by Huntington's data. Strikingly, no second reverse wave is really apparent. Rather, the period from the late 1950s to the mid-1970s may be characterized as one of relatively trendless fluctuation, leading to the breaking of a new wave of democratization in 1976 and the subsequent explosion of democratization since 1990.

[8] Huntington (fn. 1) 7, 14–17.
[9] Ibid., 16.

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These findings are important not only because they suggest a somewhat altered sequencing and a more accurate count of democratization waves but also because they cast real doubt on the appropriateness of the wave metaphor. With regard to the spread of democracy we certainly see flows; the ebbs, however, are less evident, indeed, are not really apparent at all from these data. Future studies should therefore also be cautious in comparing, explaining, and forecasting different waves of democratization.

The Problem of Classification and Conceptualization

Following Dahl, [10] Huntington defines democracy as a political system that meets the three requirements of competition, inclusiveness, and civil liberties.[11] This definition, which basically corresponds to more recent attempts to define liberal democracy, has become increasingly important as scholars have drawn attention to the increasing number of countries that are characterized by inclusive suffrage and open competition but that at the same time lack a fully developed system of civil liberties.[12] These countries underline the fact that the dimension of civil liberties can be quite independent of the dimensions of competition and inclusion. In keeping with the more recent literature, these are defined here as "minimal democracies."[13]

Although Huntington's definition is clear in seeming to focus on liberal democracies, his actual classification of political regimes is not transparent.[14] It is not at all clear, for example, how the dimension of

[10] Dahl (fn. 6) emphasizes that there is no country in which these conditions are perfectly met; therefore he prefers the term "polyarchies" for political systems in which the conditions are sufficiently met and uses the term "democracy" for the ideal type. In this research the term "liberal democracy" will be used for Dahl's polyarchies, because the term "democracy" is more common in daily language.

[11] Huntington (fn. 1), 7.

[12] Cf. Larry Diamond, Juan Linz, and Seymour Martin Lipset, *Politics in Developing Countries: Comparing Experiences with Democracy* (Boulder, Colo.: Lynne Rienner, 1995); Larry Diamond, "Is the Third Wave Over?" *Journal of Democracy* 7 (July 1996); Mark J. Gasiorowski, "An Overview of the Political Regime Change Dataset," *Comparative Political Studies* 29 (August 1996); Andreas Schedler, "What Is Democratic Consolidation?" *Journal of Democracy* 9 (April 1998); Schmitter (fn. 3); George Sorensen, *Democracy and Democratization* (Boulder, Colo.: Westview Press, 1998); Fareed Zakaria, "The Rise of Illiberal Democracy," *Foreign Affairs* 76 (November–December 1997).

[13] Multiple labels are applied to indicate the same concept; this type of regime has been variously described. It is called "formal" or "electoral democracy" in Axel Hadenius, "The Duration of Democracy: Institutional versus Socio-Economic Factors," in David Beetham, ed., *Defining and Measuring Democracy* (London: Sage Publications, 1994), 69; and in Diamond (fn. 12). It is called "democradura" in O'Donnell and Schmitter, "Tentative Conclusions about Uncertain Democracies," in O'Donnell and Schmitter, eds., *Transitions from Authoritarian Rule: Prospects for Democracy* (Baltimore: Johns Hopkins University Press, 1986), 9. And it is called "illiberal democracy" in Zakaria (fn. 12).

[14] Dankwart A. Rustow, "The Surging Tide of Democracy," *Journal of Democracy* 3 (January 1992), 121.

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civil liberties is measured. In addition, what is sometimes neglected in Huntington's treatment is that account be taken of *both* of Dahl's other two dimensions, that is, universal suffrage—or inclusiveness—in addition to competition. Although it is a commonplace to incorporate the inclusiveness dimension into the *concept* of democracy, this dimension is often ignored in the actual *measurement* of democracy. It is therefore still necessary to underline the importance of this dimension. Indeed, it is surprising how many quantitative studies, like Huntington's, ignore the suffrage dimension and hence consider more exclusive regimes as also being "democratic."[15] Bollen, for example, neglects this dimension almost entirely, arguing that (voter) participation is only marginally related to democracy, particularly because voter participation also has a symbolic value that is, or was, often employed in nondemocratic countries. Thus he cites data from the early 1970s to show that Albania, North Korea, the Soviet Union, Romania, and Bulgaria were among those countries recording the highest levels of electoral participation while noting that "very few researchers would consider any of these countries as highly democratic."[16] Further evidence that Bollen cites against using electoral participation as a valid measure of political democracy is its low level of correlation with other attested indicators of democracy, such as the fairness of elections.

There is a danger here, however. By neglecting the inclusiveness dimension, one risks adopting a measurement of democracy that is biased or even racist or sexist. Bollen, to illustrate, will consider a regime with extensive opportunities for liberalization as democratic, even though only a very small proportion of the society (for example, only white men) may be allowed to participate.[17] Further, although it is obviously true that electoral participation may be of symbolic value to authoritarian regimes, which cannot be considered democratic, this is hardly a compelling argument for excluding the dimension of inclusiveness altogether. In Dahl's initial formulation, such regimes were defined as inclusive hegemonies, that is, as inclusive regimes without competition. Finally, the fact that these two dimensions scarcely correlate does not constitute an argument against incorporating inclusiveness as a property of democracy; rather, this simply indicates that these are in fact

[15] E.g., Bollen (fn. 7, 1980 and 1993); Gastil (fn. 7); Jaggers and Gurr (fn. 7); Alvarez et al. (fn. 7).
[16] Bollen (fn. 7, 1980), 373.
[17] Likewise, in Gurr's Polity III data set the South African Apartheid regime gets a score of 5. This score is quite high on the scale from −10 to +10, especially if one bears in mind that the Fifth Republic of France gets a score of 6. The inclusiveness dimension is clearly ignored in Gurr's measurement.

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two quite independent dimensions. For the purposes of this research note, therefore, regimes in which competition coexists with noninclusive suffrage—Dahl's competitive oligarchies—will be regarded as nondemocratic regimes.[18]

What is required, therefore, is a classification that not only is transparent and consistent but that also incorporates inclusiveness. In fact, four main types of regime may be distinguished here: liberal democracies, minimal democracies, authoritarian systems, and interrupted regimes. A liberal democracy is a regime in which there is meaningful and extensive competition, sufficiently inclusive suffrage in national elections, and a high level of civil and political liberties. Minimal democracies are those political regimes with competition and inclusive suffrage but without a high level of civil liberties. Authoritarian regimes are those political regimes that fail to meet the first requirement of competition and/or the second requirement of inclusiveness. Finally, a country will be classified here as an interrupted regime if it is occupied by foreign powers during wartime, or if there is a complete collapse of central authority, or if it undergoes a period of transition during which new polities and institutions are planned.[19]

Not all of these criteria are equally susceptible to long-term historical analysis, of course, and a lack of comparable evidence over time makes it impossible to measure Dahl's third requirement of civil liberties.[20] Accordingly, this analysis does not include the waves of liberal democracies and is limited to the establishment and withdrawal of the minimal democratic systems.

[18] It should also be pointed out that voter turnout is not an adequate indicator of inclusiveness, reflecting instead factors that have little to do with measuring the right to participate in national elections (inclusiveness). Rather, structural indicators such as the institutional guarantees to participate in elections are required to calculate this second requirement of democracy. This also means that the many rich data sets on voter turnout cannot be used in this research. These include, for example, Arthur S. Banks, *Cross-Polity Time-Series Data*, assembled by Arthur S. Banks and the staff of the Center for Comparative Political Research, State University of New York at Binghamton (Cambridge: MIT Press, 1971); Tatu Vanhanen, *The Emergence of Democracy: A Comparative Study of 119 States, 1850–1979* (Helsinki: Finnish Society of Sciences and Letters, 1984); idem, *Prospects of Democracy: A Study of 172 Countries* (London: Routledge, 1997); IDEA, *Voter Turnout from 1945 to 1997: A Global Report* (Stockholm: IDEA, 1997).

[19] There are other quite equivalent and interesting classifications of democracy, but these are not useful for the present research. See Mitchell Coppedge and Wolfgang H. Reinecke, "Measuring Polyarchy," in Inkeles (fn. 7); Alvarez et al. (fn. 7); Gasiorowski (fn. 12). These classifications are available only for one specific year (e.g., Coppedge and Reinecke), or for a limited period since 1950 (Alvarez et al. [fn. 7]), or they are limited to developing countries (Gasiorowski [fn. 12]). What are needed in the context of this study are measures of democracy that cover both a long period of time and all independent countries.

[20] Gastil's data on civil liberties are available only for the period since 1973, and hence transitions toward liberal democracies can be determined and investigated only since then.

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Measuring Minimal Democracy

The first requirement of minimal democracies, the presence of competition, can be seen to be met if there exist institutions and procedures through which citizens can express effective preferences about alternative policies at the national level and if there are institutionalized constraints on the exercise of power by the executive. Indicators of these phenomena have already been collated in Gurr's well-known Polity III data set, which covers most independent countries on an annual basis from 1800 to 1994; it is therefore an ideal source to measure the presence of competition.[21] Moreover, these data are also easily adapted to the definition of competition employed in this analysis.[22] In operational terms, I will consider a national political system to be competitive if there is at least one executive chosen by competitive popular elections (if Gurr's indicator "competitiveness of executive recruitment" is coded 3 or 4); if all the politically active population has an opportunity, in principle, to attain an executive position through a regularized process (if Gurr's indicator "openness of executive recruitment" is coded 3 or 4); if alternative preferences for policy and leadership can be pursued in the political arena, such that oppositional activity is not restricted or suppressed (if Gurr's indicator "competitiveness of participation" is coded 0, 3, 4, 5); and if there are at least substantial limitations on the exercise of executive power (if Gurr's indicator "constraints on the power of the chief executive" is coded 4, 5, 6, or 7).[23]

The second requirement of minimal democracies is that there be inclusive, universal suffrage at the national level. The norm of universality requires that all citizens of the state—without regard to sex, race, language, descent, income, land holdings, education, or religious beliefs—formally enjoy the right to vote and to be elected to public office. The fact that certain prerequisites are demanded, such as a minimum age, a sound mind, or the absence of criminal record, does not negate this principle. Only countries that at some stage meet the first requirement of competition from 1800 to 1994 are considered when measur-

[21] Ted Robert Gurr, "Persistence and Change in Political Systems," *American Political Science Review* 74 (December 1974); Ted Robert Gurr, Keith Jaggers, and Will H. Moore, "Polity II Codebook" (Manuscript, University of Colorado, Boulder, 1989); Gurr, Jaggers, and Moore, "The Transformation of the Western State: The Growth of Democracy, Autocracy, and State Power since 1800," in Inkeles (fn. 7); Jaggers and Gurr (fn. 7).

[22] Gurr himself talks about scores of autocracy and democracy, but it is nevertheless clear that what he is measuring is competition. That is why I label this scale a "competition-scale."

[23] These choices are more fully explained in Renske Doorenspleet, "Democracy, Transitions, and Waves" (Manuscript, Department of Political Science, University of Leiden, the Netherlands, July 1998).

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ing the inclusiveness of the system.[24] Levels of inclusiveness of the political system may be broken down into one of the following four categories: (1) no popular suffrage; (2) suffrage denied to large segments of the population (more than 20 percent is excluded); (3) suffrage with partial restrictions (less than 20 percent of the population is excluded); (4) universal suffrage or minor restrictions.[25] For the purposes of this analysis, countries are considered "sufficiently" inclusive to meet the criterion of a minimal democracy if they fall into the third or fourth category.[26] Should they fall within either of the first two categories or should they not meet the competition criterion, they are classified as authoritarian regimes. Reliable data on inclusiveness are of course difficult to obtain and to standardize, and I have had to rely on historical sources and various monographs for each country, as well as on *Keesing's Record of World Events* and many of the standard handbooks and almanacs.[27] The appendix gives an overview of the years in which political systems can be considered as both competitive and inclusive and hence are classified in this study as "minimal democracies."

Interrupted regimes are defined as those countries that are occupied by foreign powers during wartime (for example, the Netherlands during

[24] Countries that did not pass the requirement of competition are authoritarian; therefore, in the context of this research there is no need to investigate the inclusiveness of these noncompetitive systems.

[25] Coppedge and Reinecke (fn. 19) used the same four categories in measuring inclusive suffrage for all political regimes in 1985. The authors dropped this variable (and dimension) of inclusiveness from the final scale because they came to the conclusion that it contributed very little empirically to the measurement of polyarchy. Consequently, their final scale is a unidimensional scale of contestation. This result is hardly surprising, in that by 1985 the dimension of "inclusiveness" had largely ceased to play an independent effect. In earlier stages of democratization, on the other hand, it is of crucial importance.

[26] This is in fact a critical choice: when do countries fulfill the requirement of inclusiveness sufficiently? Of course, if a country falls in the first category. But what if there are partial restrictions? In the event, however, only two countries appear to fall in the second category "suffrage with partial restrictions" (less than 20 percent of the population is excluded): Chile excluded 10 percent of the population by literacy requirements until 1970, and in the United States, a variety of devices, such as poll taxes, literacy tests, and property qualifications, prevented virtually all blacks (10 percent of the population) from voting. I decided to treat these two cases as exceptional ones and I will consider Chile in 1949 and the United States in 1920 as "inclusive" enough when they granted women the right to vote. It has to be pointed out, in addition, that a country is considered to be inclusive *since* the year in which the formal right to participate can be carried out, that is, since the year in which the first inclusive elections are actually held. Hence, although Dutch women had the formal right to vote already in 1919, they could not exercise this right until the 1922 elections; consequently, the Netherlands is classified as a "minimal democracy" only since 1922.

[27] Examples of the handbooks and almanacs that were used to investigate the inclusiveness over time of the political regimes in this study are Chris Cook and John Paxton, *European Political Facts, 1918–1973* (London: MacMillan, 1975); George E. Delury et al., *World Encyclopedia of Political Systems*, 2 vols. (Essex: Longman, 1983); Ian Gorvin et al., *Elections since 1945: A World-wide Reference Compendium* (Harlow: Longman, 1989); Lipset et al., eds., *The Encyclopedia of Democracy*, vols. 1–4 (London: Routledge, 1995); Thomas T . Mackie and Richard Rose, *The International Almanac of Electoral History* (London: MacMillan, 1991); Stein Rokkan and Jean Meyrat, *International Guide to Electoral Statistics* (The Hague and Paris: Mouton, 1969).

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World War II), that experience a complete collapse of central authority, say, during civil war (for example, Lebanon, 1978–86), or that undergo a period of transition during which new polities and institutions are planned, legally constituted, and put into effect (for example, Argentina in 1982). Gurr's Polity III data set includes useful data recording these experiences, and in operational terms, I have chosen to classify countries as interrupted when they have Gurr codes of 66, 77, or 88.[28]

Waves of Democracy

Having established these criteria, I now consider how the waves of democracy developed over time. First, and following researchers who measure democracy by taking account only of Dahl's requirement of competition, the empirical trends in the growth of "democratic" systems from 1800 to 1994, measured as a percentage of all countries, are summarized in Figure 1. This appears more or less to replicate Huntington's findings, albeit here updated to 1994. From these figures, his three waves of democratization can in fact be readily distinguished. In addition, Figure 1 shows that the staging points of democratization in terms of waves and reverses generally closely resemble those identified by Huntington: there is a first, long wave of democratization (1810–1922), a first reverse wave (1923–40), a second wave of democratization (1944–57), a second reverse wave (1957–73), and a third wave of democratization (since 1973).

Although these updated figures fail to confirm Huntington's statement that there is a less than optimistic two-step-forward, one-step-backward pattern, they nevertheless do show that the proportion of democratic states during the third wave rises well above its previous peaks. Huntington's less optimistic conclusions are probably simply due to the fact that his analysis ended in 1990, whereas in the following few years the proportion of democratic states increased enormously, from 43 percent in 1990 to more than 57 percent in 1994. This percentage is much higher than the percentages of democracies in the first peak; that is, it is higher than the 38 percent in 1922, and it is also higher than the 35 percent in 1960. So although the trend toward democratization as defined in these limited terms may not be irreversible, the long-term trend in Figure 1 does not appear to reflect a genuine two-step-forward, one-step-backward pattern and reveals no signs as yet (through to 1994) to indicate a third reverse wave.

[28] Gurr, Jaggers, and Moore (fn. 21, 1989), 6–8.

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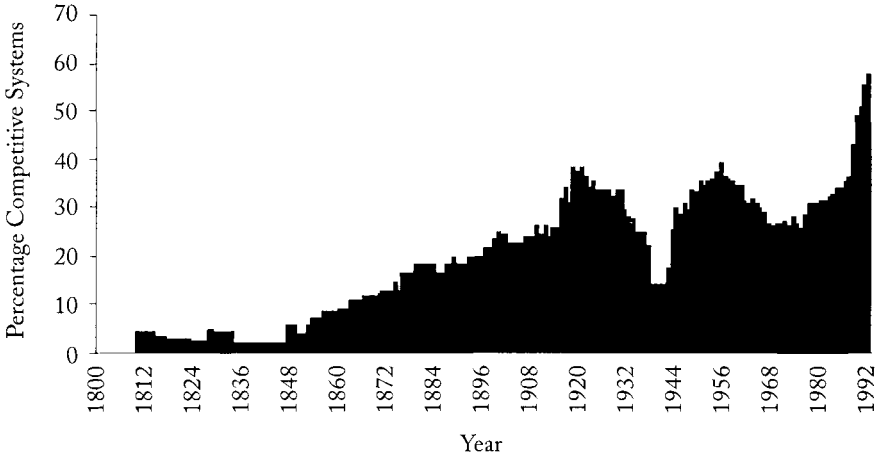

FIGURE 1
PERCENTAGE COMPETITIVE SYSTEMS
(BY YEAR)

WAVES OF MINIMAL DEMOCRACY

As is evident, however, these data fail to include the requirement of inclusive suffrage and therefore do not refer to the development of what we define as minimal democracies. Once this second measure is included for this more complete definition of minimal democracy, we may expect to see a very different pattern. As can be seen from Figure 2, which plots the percentage of minimal democracies from 1800 to 1994, this is in fact the case.

In this new application, the first wave can be seen to begin at a much later stage, confirming that democratization in this more complete sense (of taking among others women's citizenship seriously) is a twentieth-century phenomenon that develops also relatively abruptly. While there were as yet no minimal democracies as late as 1890, by 1923 almost a quarter of the independent political systems in the world had achieved that status. The first peak is lower in Figure 2 than in Figure 1, in that several competitive systems had not yet extended the suffrage to women (for example, Belgium, Costa Rica, France, Portugal, Spain, Switzerland) and hence, strictly speaking, cannot be considered as minimal democracies. The second peak, in 1955, is also slightly lower (by 4.5 percent) in Figure 2, in that Brazil, Peru, Sudan and Switzerland, while competitive, were not yet minimal democracies. The second reverse wave, which is now much smaller in comparison with Figure 1,

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FIGURE 2
PERCENTAGE MINIMAL DEMOCRACIES
(BY YEAR)

results in a fall to 27 percent in 1973. However it should also be noted that from this point onward the percentages are the same in both figures, thus indicating that the requirement of inclusive suffrage no longer exerts any influence. Hence the third wave is also evident in Figure 2.

EMPIRICAL PROBLEMS

Until now, I have followed the researchers who studied the waves of transitions by focusing on percentages of democracies among world states.[29] But does such a focus really offer insight into the waves of transitions? Remember that a wave of democratic transitions is defined as a group of transitions from authoritarian regimes to (minimal) democracies that occurs within a specified period of time and in which the transitions significantly outnumber transitions in the opposite direction. In investigating such waves, the focus on percentages of democracies in the world can be very confusing, for two reasons in particular.

First, although there may be fewer minimal democracies during a reverse wave, this does not necessarily mean that those states have reverted to authoritarianism; it may mean, instead, that several states have experienced an interrupted period. Consider, for example, the first reverse

[29] Huntington (fn. 1); Jaggers and Gurr (fn. 7); Kristian S. Gleditsch and Michael D. Ward, "Double Take: A Reexamination of Democracy and Autocracy in Modern Polities," *Journal of Conflict Resolution* 41 (June 1997).

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wave from 1923 to 1940, which seems to be evident in Figure 2. Indeed, there were certain democratic regimes, such as Poland, Germany, and Italy, which did retreat to authoritarianism during this period. There were, however, also other countries, such as Luxembourg, the Netherlands, Norway, and Denmark, that were minimal democracies in the 1920s and yet did not really step backward. What actually happened was that these countries experienced a difficult period of interruption following the German invasion and the subsequent foreign domination of their own national political regimes before being restored to democracy in 1945. In neither case, however, should they be considered to be part of a wave or reverse wave, in that they neither moved toward (in 1940) nor away from (in 1945) authoritarianism. While Huntington does not distinguish between such transitional regimes and genuinely authoritarian regimes (he simply considered transitional countries to be authoritarian), I believe this distinction to be particularly important. Thus, to gain a more accurate sense of (reverse) waves of democratization, it would seem more appropriate to exclude these interrupted cases and hence to plot only the genuine percentages of democracies and authoritarian regimes. The principal effect of doing this, of course, is to reduce the levels of the first reverse wave of transitions.

A second and more crucial empirical problem is that changes in the proportion of minimal democracies around the world can occur simply because the denominator (the number of states) itself changes. As can be seen from Figure 2, for example, the percentage of minimal democracies in the world falls from more than 32 percent in 1957 to 26 percent in 1972—an evident reversal, or so it would seem. Yet at the same time the sheer numbers of minimal democracies actually increased from thirty to thirty-seven, suggesting significant progress toward democracy. In fact, this apparent paradox is easily explained by reference to the widespread decolonization in Africa and the subsequent enormous growth of independent states from 93 in 1957 to 137 in 1972. Moreover, most of these new states were authoritarian—in 1972 only eight of the forty-four new states were democratic. Huntington considers this as part of a transition process, suggesting that these new states *became* authoritarian at independence.[30] In my view, however, this is certainly not evidence of a "global swing away from democracy"[31] but is rather a process by which new authoritarian states were simply created or installed. Hence the second reverse wave that appears in Figure

[30] Huntington (fn. 1), 20–21.
[31] Ibid., 21.

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2 should not be interpreted as exclusively reflecting regime transitions away from democracy; it also reflects the *installation* of many newly independent authoritarian regimes.

From this it follows that we can gain a better and more accurate insight into the real *transitions* toward (and away from) minimal democracy and hence into the waves of democracy by excluding those states that have either (1) experienced an interruption of their own national regimes or (2) become newly established as independent regimes,[32] and by focusing on the real numbers rather than on the otherwise misleading percentages. In other words, by plotting the number of transitions from (independent) authoritarian to democratic systems less the number of transitions from minimal democracies to authoritarian systems over time, we gain a more accurate and meaningful insight into the question of whether the transitions to democracy outnumber the transitions to authoritarianism or vice versa. In 1920, for example, this difference is (+) 5, in that Austria, Czechoslovakia, Denmark, Estonia, and the United States each became a minimal democracy, while no single country followed the reverse path. In 1973, by contrast, the difference is (+) 1, in that two countries became democratic (Argentina and Turkey), while one other reverted to authoritarianism (Chile). The overall results of this revised analysis are summarized in Figure 3.

In order to effect a more appropriate comparison over time, however, it may still be necessary to build in some control for the growth in the number of states in the world, particularly since this may increase not only the probability that transitions will take place but also the difference between transitions to minimal democracy and transitions to authoritarianism. Consider the following hypothetical situations during two points in time: (1) there are 12 countries, of which 3 make a transition to authoritarianism and 4 to democracy; (2) there are 120 countries, of which 30 make a transition to authoritarianism and 40 to democracy. In the first situation, transitions to democracy outnumber transitions in the opposite direction by 1, while in the second situation the relevant figure is 10. In terms of relative proportions, however, the situations are identical, and hence each might be seen to reflect an equivalent "wave." Comparisons over time may therefore require the data to be standardized in the following manner:

[32] One could object that I neglect the new state's choice of its own regime type by excluding those states that have become newly established as independent regimes. However, Huntington himself defines a wave as a group of transitions, and I do not regard as "transitions" the institution of new regimes as a result of decolonization. Processes of state building should be separated from processes of transition.

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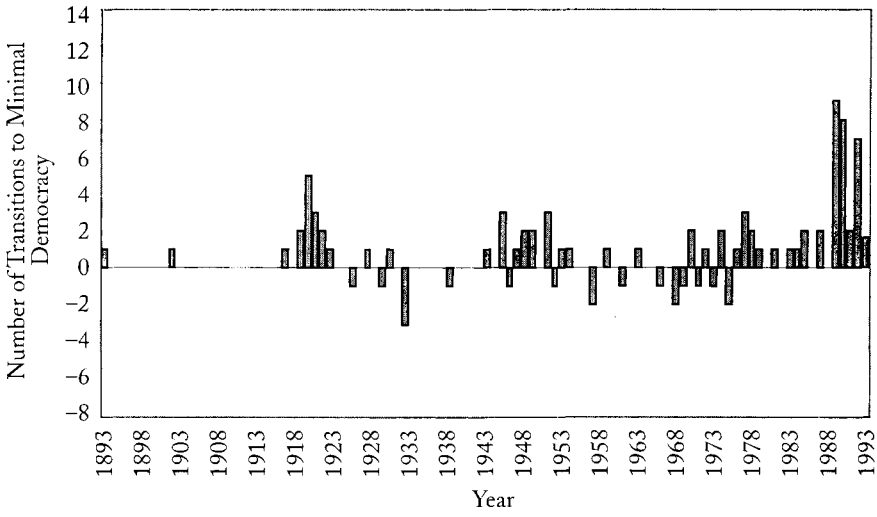

FIGURE 3
NUMBER OF TRANSITIONS TO MINIMAL DEMOCRACIES
(BY YEAR)

WT (t) = N (1994) * Trans (t) / N (t)
where
WT (t) = weighted number of transitions in year t
N (1994) = number of countries in 1994 (= 156)
Trans (t) = number of transitions in year t
N (t) = number of countries in year t

This formula takes the year 1994 as the standard against which the number of transitions will be weighted in this study. (See the appendix for the list of regime changes from 1800 through 1994.) The standardized data are summarized in Figure 4, with more detailed figures on the different waves indicated there being presented in Table 1.

Based on the standardized data and with a view to reassessing Huntington's three waves, the following periods can be distinguished: a first impressive wave of democratization in 1893–1924; a first reverse wave in 1924–44; a second wave of democratization in 1944–57; a period of relatively trendless fluctuation in 1957–76; and finally a third wave of democratization in 1976–89 that is then followed by the explosion of democratization since 1990. The first wave of transitions to democracy till 1924 is clearly very important and very striking. It is also clear that there has been a significant wave of democratization since 1976 and

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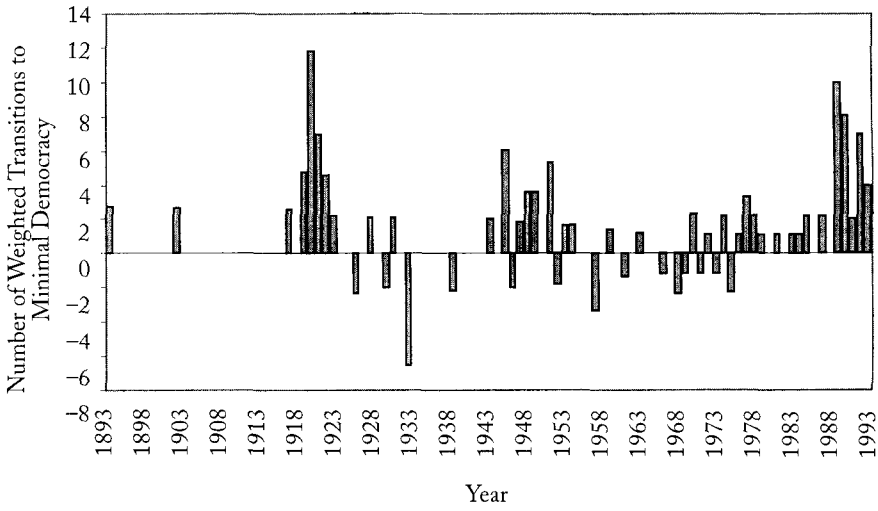

FIGURE 4
NUMBER OF WEIGHTED TRANSITIONS TO MINIMAL DEMOCRACIES
(BY YEAR)

that there has been a real upsurge of transitions to democracy since 1990. What is perhaps more striking, however, is that Huntington's other waves no longer emerge with such significance. Although the first reverse wave between 1924 and 1944 and the second wave of democratization during the mid-1940s and 1950s may still be distinguished, they are nevertheless not as convincing as seemed apparent in Figures 1 and 2. Moreover, there is no clear second reverse wave of democratization, which, according to Huntington, should have been apparent between 1957 and 1973. In fact, this period is better described as one of trendless fluctuation, in which there are waves of both authoritarianism and democracy.

CONCLUSION

This analysis has investigated the extent of the variation in transitions of political regimes that has occurred across different countries and over time. In studying the aggregated percentages of democratic regimes in the world over time, one can distinguish the three waves initially identified by Huntington. When the requirement of inclusive suffrage is imposed, however, the first wave is seen to begin much later, indicating that transitions to minimal democracy are a twentieth-century phe-

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TABLE 1
REGIME TRANSITIONS PER WAVE

	# Transitions to Democracy	*# Transitions to Authoritarianism*	*# Transitions Outnumbered*[a]	*# Transitions Outnumbered,*[a] *Weighted by Countries*
First wave, 1893–1924	16	0	16	39
Reverse wave, 1924–44	3	7	−4	−9
Second wave, 1944–57	15	3	12	22
Fluctuation, 1957–76	16	18	−2	−3
Third wave, 1976–90	24	12	12	13
Explosive wave, 1990–94	34	4	30	31

SOURCES: For full details, see the appendix.
[a] Transitions outnumbered refers to transitions to democracy minus transitions to authoritarianism.

nomenon. Moreover, the peaks of the first and second wave of democratization also appear to be lower. Nor has this research confirmed Huntington's statement that there is a less than optimistic two-step-forward, one-step-backward pattern. Although the trend toward democratization may not be irreversible, the long-term trends in Figures 1 and 2 do clearly point to more long-term progress than Huntington has suggested.

This analysis also suggests that the focus on percentages of transitions may prove quite misleading. Since these percentages are susceptible to changes in the numbers of world states as well as in the numbers of transitions themselves, it is argued that a more accurate and meaningful impression of the waves of democratization can be achieved by plotting the real numbers involved in both transitions from authoritarian to minimal democracy and vice versa. These numbers may also be standardized to facilitate a genuine comparison over time. This new approach suggests that while the first wave of transitions to democracy still appears to be very striking, there is no longer any strong evidence of a second reverse wave, and the explosion of democratization in the period 1990–94, in which an impressive total of thirty-four authoritarian regimes effected a transition to minimal democracy, emerges with real force.

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Why are these findings relevant? First, this article shows how important it is to have a clear conceptualization and classification of "democratic regime." Scholars interested in historical processes of regime changes in order to identify waves of democratization should always use a consistent distinction between democratic and authoritarian regimes. In addition, they should pay attention not only to the dimension of competition but also to the dimension of inclusiveness. This latter dimension is particularly important prior to the 1970s, when it discriminates powerfully between regimes. Since the 1970s, by contrast, almost all competitive regimes have been characterized by inclusive suffrage. By taking into account the dimension of inclusive suffrage, it can be seen that the first wave of democratization starts later and the second reverse wave is less distinctive.

Second, the findings in this research note emphasize that future researchers should be more attuned to the implications of the changing number of states over time. Researchers who focus on *percentages* of democratic regimes among the states of the world assume a fixed underlying geography; they typically think that the topology remains constant. World history, however, has witnessed the emergence of many new states, for example, as a consequence of the African decolonization in the 1960s and the independence of the former Soviet republics in 1991. By calculating the actual *number* of states (instead of percentages) that made a transition from nondemocracy to democracy or vice versa, one arrives at a better insight into the real waves of democratization.

Third, these results indicate that future studies should be careful in comparing and explaining different waves of democratization. Huntington himself recommends such a comparison: "If the third wave of democratization slowed down or came to a halt, what factors may produce and characterize a third reverse wave? The experience of the first and second reverse wave may be relevant."[33] Although it is reasonable to expect that prior experiences suggest potential causes of future developments, future studies in which reverse waves are compared will be useless, because there are *no* clear reverse waves.

Finally, these findings are important not only because they suggest a somewhat altered sequencing and a more accurate count of democratization waves but also because they imply real doubt about whether the wave metaphor is the most appropriate way to conceptualize the problem. Since reverse waves are not really apparent from these data, it may be better to think in terms of "steps" toward democratization. There are

[33] Huntington (fn. 1), 292.

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certainly flows, but the ebbs are much less evident than had been averred. The way one counts influences how one thinks about the prospects for the continued expansion of democracy in the world. Many researchers simply expect a reverse wave in the near future and are waiting for it because they think that each wave is inevitably followed by a reverse wave. Are we on the edge of such a reversal? On the basis of the findings reported in this article, we know now that it is empirically possible for a wave of democratic expansion to be followed for some time not by a reverse wave but rather by an equilibrium in which the overall number of democracies in the world neither increases nor decreases significantly. It seems then that a period of trendless fluctuation is empirically more likely than a reverse wave.

Appendix: Political Regime Changes, 1800–1994

A complete listing of regime changes is given in this appendix. Following each country is a list of all regime changes identified for that country. D indicates that a minimal democracy was established; regimes are considered as minimal democratic when they fulfill both the requirement of inclusiveness (measured by codings of the author) and the requirement of competition (measured by codings of Gurr's Polity III data set). A indicates that an authoritarian regime was established; regimes are considered as authoritarian when they do not fulfill the requirement of inclusiveness or the requirement of competition. I represents an interruption, interregnum, or transition period (measured by code –77, –66, –88 from Gurr's Polity III data set). Germany refers to Germany before 1948 and to West Germany after 1948; Czechoslovakia refers toCzechoslovakia before 1993 and to the Czech Republic after 1993.

Afghanistan 1800 A, 1992 I
Albania 1914 A, 1915 I, 1925 A, 1939 I, 1945 I, 1946 A, 1992 D
Algeria 1963 A
Angola 1975 A
Argentina 1825 A, 1830 I, 1835 A, 1852 I, 1852 A, 1946 I, 1948 A, 1955 I, 1957 A, 1973 D, 1976 A, 1983 D
Armenia 1991 D
Australia 1901 A, 1902 D
Austria 1800 A, 1805 I, 1806 A, 1809 I, 1810 A, 1818 I, 1920 D, 1933 I, 1934 A, 1938 I, 1945 I, 1946 D

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Azerbaijan 1991 A
Baden (1818–71) A
Bahrain 1971 A
Bangladesh 1972 D, 1974 A, 1991 D
Bavaria (1800–1871) A
Belarus 1991 D
Belgium 1831 A, 1914 I, 1915 A, 1940 I, 1945 A, 1949 D
Benin 1960 A, 1963 I, 1965 A, 1990 I, 1991 D
Bhutan 1907 A
Bolivia 1826 A, 1841 I, 1842 A, 1871 I, 1873 A, 1952 I, 1956 A, 1982 D
Bosnia 1992 I
Botswana 1966 A, 1969 D,
Brazil 1824 A, 1930 I, 1934 A, 1945 I, 1946 A, 1964 I, 1965 A, 1985 D
Bulgaria 1879 A, 1913 I, 1915 A, 1942 I, 1944 I, 1947 A, 1990 D
Burkina Faso 1960 A, 1977 I, 1978 D, 1980 A
Burundi 1961 A, 1965 I, 1966 A
Cambodia 1950 A, 1953 I, 1955 A, 1970 I, 1972 A, 1975 I, 1976 A, 1991 I, 1993 D
Cameroon 1961 A
Canada 1867 A, 1921 D
Central African Republic 1962 A, 1993 D
Chad 1962 A, 1978 I, 1979 I, 1985 A
Chile 1818 A, 1924 I, 1925 A, 1955 D, 1973 A, 1990 D
China 1800 A, 1860 I, 1862 A, 1911 I, 1912 A, 1913 I, 1914 A, 1939 I, 1946 A
Colombia 1832 A, 1860 I, 1861 A, 1958 D
Comoros 1975 A, 1990 D, 1994 A
Congo 1961 D, 1963 A, 1991 I, 1992 D
Costa Rica 1838 A, 1919 I, 1920 A, 1949 D
Croatia (1830–1915) 1830 A, 1860 I, 1861 A, 1868 I, 1869 A
Croatia (1991–94) A
Cuba 1902 A, 1916 I, 1918 A, 1952 I, 1955 A, 1959 I, 1961 A
Czechoslovakia 1918 A, 1920 D, 1939 I, 1945 D, 1947 I, 1948 A, 1968 I, 1969 A, 1990 D
Democratic People's Republic of Korea 1948 A
Democratic Republic of Vietnam 1954 A
Denmark 1800 A, 1901 I, 1915 A, 1920 D, 1940 I, 1945 D
Dominican Republic 1844 A, 1861 I, 1865 A, 1914 I, 1925 A, 1930 I, 1932 A, 1961 I, 1962 A, 1963 I, 1964 A, 1978 D
Ecuador 1830 A, 1980 D

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Egypt 1811 A, 1882 I, 1923 A, 1928 I, 1930 A, 1935 I, 1936 A, 1952 I, 1953 A
El Salvador 1841 A, 1855 I, 1858 A, 1948 I, 1950 A, 1979 I, 1984 D
Estonia 1917 A, 1919 I, 1920 D, 1933 I, 1936 A, 1941 I, 1988 I, 1991 A
Ethiopia 1855 A, 1936 I, 1942 A, 1991 I, 1994 A
Fiji 1970 D, 1987 A
Finland 1916 A, 1917 D, 1930 I, 1931 A, 1944 D
France 1800 A, 1851 I, 1852 A, 1860 I, 1863 A, 1870 I, 1877 A, 1944 I, 1946 D, 1958 A, 1969 D
Gabon 1961 A, 1990 I, 1991 A
Gambia 1965 A, 1966 D, 1994 A
Georgia 1991 A
German Democratic Republic (1949–89) A
Germany 1800 A, 1907 I, 1813 A, 1868 I, 1871 A, 1918 I, 1919 D, 1933 A, 1946 I, 1949 D
Ghana 1960 A, 1969 I, 1970 A, 1978 I, 1979 D, 1981 A, 1991 I, 1992 A
Gran Colombia 1821–30 A
Greece 1827 A, 1862 I, 1864 A, 1917 I, 1920 A, 1922 I, 1924 A, 1941 I, 1944 A, 1974 I, 1975 D
Guatemala 1839 A, 1871 I, 1873 A, 1879 I, 1880 A, 1985 I, 1986 D
Guinea 1958 A
Guinea-Bissau 1974 A, 1994 D
Guyana 1966 A, 1992 D
Haiti 1820 A, 1915 I, 1918 A, 1946 I, 1950 A, 1986 I, 1988 A, 1990 D, 1992 A, 1994 D
Honduras 1839 A, 1853 I, 1854 A, 1907 I, 1908 A, 1912 I, 1913 A, 1919 I, 1920 A, 1924 I, 1925 A, 1981 I, 1982 D
Hungary 1867 A, 1918 I, 1919 A, 1944 I, 1948 A, 1956 I, 1957 A, 1990 D
Iceland 1918 A, 1934 D
India 1950 A, 1952 D
Indonesia 1945 A
Iran 1800 A, 1906 I, 1921 I, 1925 A, 1953 I, 1955 A
Iraq 1924 A
Ireland 1922 A, 1923 D
Israel 1949 D
Italy 1861 A, 1922 I, 1928 A, 1943 I, 1945 I, 1948 D
Ivory Coast 1960 A
Jamaica 1959 D
Japan 1800 A, 1858 I, 1868 A, 1945 I, 1952 D

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Jordan 1946 A
Kazakhstan 1991 A
Kenya 1965 A
Korea (1800–1910) A
Kuwait 1963 A, 1990 I, 1991 A
Kyrgyzstan 1991 D
Laos 1954 I, 1958 A, 1971 I, 1975 A
Latvia 1920 D, 1934 A, 1941 I, 1991 A
Lebanon 1944 A, 1971 D, 1976 I, 1990 A
Lesotho 1966 D, 1970 A, 1993 D
Liberia 1847 A, 1990 I
Libya 1951 A
Lithuania 1918 A, 1926 I, 1928 A, 1941 I, 1991 D
Luxembourg 1867 A, 1919 D, 1940 I, 1945 D
Macedonia 1991 D
Madagascar 1961 A, 1992 I, 1993 D
Malawi 1965 A, 1994 D
Malaysia 1957 D, 1969 A, 1971 D
Mali 1960 A, 1991 I, 1992 D
Mauritania 1961 A
Mauritius 1969 D
Mexico 1822 A, 1834 I, 1835 A, 1846 I, 1848 A, 1863 I, 1864 A, 1876 I, 1880 A, 1911 I, 1917 A
Modena (1815–60) A
Moldavia 1991 A
Mongolia 1924 A, 1993 D
Morocco 1800 A, 1912 I, 1956 A
Mozambique 1976 A, 1994 D
Myanmar (Burma) 1948 D, 1962 A
Namibia 1990 D
Nepal 1800 A, 1958 I, 1959 A, 1991 D
Netherlands 1815 A, 1922 D, 1940 I, 1945 D
New Zealand 1857 A, 1893 D
Nicaragua 1838 A, 1926 I, 1927 A, 1979 I, 1981 A, 1990 D
Niger 1959 A, 1991 I, 1993 D
Nigeria 1960 A, 1978 I, 1979 D, 1984 A
Norway 1814 A, 1921 D, 1940 I, 1945 D
Oman 1800 A, 1957 I, 1959 A
Orange Free State (1854–1902) A
Pakistan 1947 A, 1950 D, 1958 A, 1993 D
Panama 1903 A, 1990 D

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Papal States (1815–70) A
Papua New Guinea 1976 A, 1977 D
Paraguay 1816 A, 1868 I, 1870 A, 1989 D
Parma (1815–60) A
Peru 1821 A, 1825 I, 1828 A, 1881 I, 1882 A, 1919 I, 1920 A, 1930 I, 1933 A, 1978 I, 1980 D, 1992 A
Philippines 1935 A, 1941 I, 1945 A, 1950 D, 1969 A, 1986 I, 1987 D
Poland 1918 A, 1922 D, 1926 A, 1939 I, 1948 A, 1991 D
Portugal 1800 A, 1801 I, 1802 A, 1807 I, 1820 I, 1823 A, 1833 I, 1834 A, 1910 I, 1911 A, 1926 I, 1930 A, 1974 I, 1976 D
Republic of Korea 1948 A, 1960 D, 1961 A, 1988 D
Republic of Vietnam (1955–75) A
Romania 1859 A, 1916 I, 1917 A, 1940 I, 1941 A, 1944 I, 1948 A, 1989 I, 1990 D
Russia 1800 A, 1812 I, 1813 A, 1905 I, 1906 A, 1991 D
Rwanda 1960 A, 1994 I
Sardinia (1815–60) A
Saudi Arabia 1926 A
Saxony (1806–71) 1806 A, 1813 I, 1814 A, 1848 I, 1849 A
Senegal 1960 A, 1962 I, 1964 A
Sierra Leone 1961 D, 1967 A
Singapore 1959 D, 1963 I, 1965 A
Slovakia 1993 D
Slovenia 1991 D
Somalia 1960 A, 1964 D, 1969 A, 1991 I
South Africa 1856 A, 1902 I, 1908 I, 1910 A, 1993 I, 1994 D
Spain 1801 A, 1808 I, 1814 A, 1836 I, 1837 A, 1869 I, 1871 A, 1874 I, 1876 A, 1930 I, 1931 D, 1939 A, 1975 I, 1978 D
Sri Lanka 1948 D, 1977 I, 1978 D, 1982 A, 1994 D
Sudan 1954 A, 1964 I, 1965 D, 1969 I, 1971 A, 1985 I, 1986 D, 1989 A
Swaziland 1968 A
Sweden 1800 A, 1809 I, 1812 A, 1907 I, 1917 A, 1921 D
Switzerland 1848 A, 1971 D
Syria 1944 D, 1949 A, 1954 D, 1958 I, 1961 A
Taiwan 1949 A, 1991 D
Tajikistan 1991 A
Tanzania 1963 A
Thailand 1800 A, 1932 I, 1935 A, 1941 I, 1942 A, 1968 I, 1969 A, 1973 I, 1975 D, 1977 I, 1978 A, 1988 D
Togo 1961 A, 1991 I, 1993 A
Trinidad 1962 D

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Tunisia 1959 A
Turkey 1800 A, 1919 I, 1922 I, 1923 A, 1946 D, 1953 A, 1960 I, 1961 D, 1971 A, 1973 D, 1980 A, 1984 D
Turkmenistan 1991 A
Tuscany (1815–60) A
Two Sicilies (1816–60) A
Uganda 1962 D, 1966 I, 1967 A, 1979 I, 1981 D, 1985 I, 1986 A
Ukraine 1991 D
United Arabic Emirates 1971 A
United Kingdom 1800 A, 1928 D
United Provinces of Central America (1824–38) A
United States of America 1800 A,1920 D
Uruguay 1830 A, 1952 D, 1972 I, 1973 A, 1985 D
Uzbekistan 1991 A
Venezuela 1830 A, 1963 D
Württemburg (1800–1871) A
Yemen 1990 I, 1994 A
Yemen Arabic Republic (1918–89) 1918 A, 1946 I, 1948 A
Yemen People's Republic (1967–89) A
Yugoslavia 1921 A, 1937 I, 1939 A, 1941 I, 1944 I, 1946 A, 1951 I, 1953 A
Zaire 1960 I, 1965 A, 1993 I
Zambia 1964 A, 1991 D
Zimbabwe 1923 A, 1979 I, 1980 D, 1983 A

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Review Article

The Study of Money

By JONATHAN KIRSHNER*

Benjamin J. Cohen. *The Geography of Money.* Ithaca, N.Y.: Cornell University Press, 1998, 229 pp.

Susan Strange. *Mad Money: When Markets Outgrow Governments.* Ann Arbor: University of Michigan Press, 1998, 212 pp.

MONETARY phenomena now define the contours of the contemporary global economy. This is new, and it has transformed the study of international political economy (IPE). By contrast, for most of the past two centuries, money, as John Stuart Mill argued (and like a good baseball umpire), was only noticeable when it failed. This was certainly the case during the dramatic expansion of the international economy following the Second World War, and it was reflected in the concurrent development of the subdiscipline of IPE. The real economy —trade, especially liberalization, integration, and strategy—dominated the agenda, while monetary politics tended to pop up when its more severe pathologies—sterling crises, the collapse of Bretton Woods, the dollar cycle—threatened to disrupt the smooth functioning of world trade.

At the dawn of the twenty-first century, however, these roles have reversed. Money leads and the real economy must follow. From an economic perspective, this has an Alice-in-Wonderland quality to it: money, once the handmaiden of the modern economy, has become its mistress. For students of IPE, this presents a fundamental and profound question: in what way are politics affected by this change?

Two excellent books, *The Geography of Money*, by Benjamin Cohen, and *Mad Money*, by Susan Strange, will frame, support, and serve as the point of departure for scholars addressing this vital question. The volumes, by two of the most accomplished and distinguished experts on

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the IPE of money, also establish landmarks around which competing schools of thought will organize. Cohen, the thoughtful liberal, trusts markets but understands that monetary phenomena have inescapably political consequences. Strange, the skeptical Keynesian, recognizes the indispensable power and efficiency of markets but sees a monetary order reeling from political conflict and ubiquitous market failure.

From these distinct perspectives, each author provides a new roadmap for navigating the international political space transformed by the ascendance of money. They also remind us why so many of the great economists, including Ricardo, Marx, Marshall, Keynes, Schumpeter, Myrdal, and Hayek, dedicated much of their efforts to the study of monetary phenomena. Deceptively theoretical debates about money—its definition, management, and idiosyncrasies—are typically rooted in fundamental conceptions of politics and society.

Ultimately, however, and perhaps necessarily, these books raise more questions than they answer. But they do suggest a direction for the most promising avenues of investigation—toward the study of the unique interconnections between the ideas, material interests, and institutions associated with the management of money. Those relationships are profoundly consequential for politics and demand the renewed attention of contemporary scholars of international relations and political economy. Cohen, and more explicitly Strange, clearly acknowledge the importance of ideas in monetary affairs. Cohen reminds the reader that money derives its very value from shared social conventions, indeed, "has no meaning at all except with reference to the mutual confidence that makes its use possible" (p. 11). Strange is even more pointed, asserting that the basic differences between competing economic theories are "not technical but political" (p. 190).

But while the role of ideas is an important implicit foundation of these volumes, neither takes on the issue in a systematic way, largely because each has a dominant theme. These themes, reflected in their respective titles, provide the nominal touchstone for their analyses. This article, therefore, proceeds in two parts. The first part considers *Geography* and *Mad Money* on their own terms, concentrating on the themes stressed by the authors. The second part of the article then explores what is left implicit by these volumes—the need for a renewed attention to ideology and politics in explaining monetary phenomena.

This latter part of the article first shows how ideas can play a unique role in shaping monetary phenomena. It then argues that this matters because those ideas can mask distributional conflicts. Fundamentally political struggles about money, that is, are routinely cloaked in eco-

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nomic terms, often throwing students of politics off the scent. This discussion then concludes with two illustrations of macroeconomic policies—the pursuit of low inflation and the deregulation of capital flows—that have been shaped by ideas that are of greater political than economic consequence.

The New Geography

As Cohen notes in his preface, he traces his interest in the geography of money to his first professional publication.[1] Even more broadly, *Geography* can be seen as the most recent and arguably the culmination of a series of important books by Cohen, including *The Future of Sterling as an International Currency*, *Organizing the World's Money*, and *In Whose Interest? International Banking and American Foreign Policy*. Each of these books negotiated the terrain between economics and politics as it also explored crucial issues relating to international money and finance. Thus *Geography* breaks new ground while also tying together arguments and analytical themes that have characterized Cohen's writing throughout his career.

Cohen's premise is straightforward. While the global financial revolution is often characterized as undermining state authority in general and national control over money in particular, "the geography of money is far more complex than we generally assume" (p. 1). Cohen quickly establishes a clear thematic foil: the myth of one nation, one money, that is, the idea that within their own borders, states are their own monetary masters. This has never been true, he argues, and is less and decreasingly an approximation of reality now than at any other time in recent history. Cross-border currency competition is a fact of life and is continuously eroding the power of governments. And this matters, because "international relations, political as well as economic, are being dramatically reshaped by the increasing interpenetration of national monetary spaces" (p. 3).

To comprehend the meaning of these changes, Cohen argues, we must understand the geography of money. The most important factor driving change in that geography is the shift in power from states to markets. This shift, however, is not a transformation from state supremacy to decentralized globalization. Rather, it is a change in the na-

[1] Benjamin J. Cohen, "The Euro-Dollar, the Common Market, and Currency Unification," *Journal of Finance* 17 (December 1963), esp. 613–15. In this paper Cohen argued, among other things, that the existence of the euro-dollar market was an important reason why the members of the European Economic Community had not developed a common currency.

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ture of state power. While at one time states could be considered the monopoly producers of currency within their borders, they have now been reduced to (still powerful) oligopolists. They retain the capacity to shape the market but also find themselves constrained by competitors.

With his foil, the one nation, one money myth, and his question, the political and economic consequences of increased interpenetration of international monetary spaces, Cohen proceeds with his argument systematically and effectively. First, looking back, *Geography* explores the old-fashioned world of territorial money from a historical perspective. While there was always sovereign coinage, Cohen notes, the conceptualization of money in territorial terms did not come about until the nineteenth century. Before then foreign coins circulated with little concern for national boundaries. But leaders overseeing the consolidation of the nation-state in the nineteenth century used money as in instrument of state building,[2] and the establishment of national money as "legal tender" drove out foreign (currency) competition.

In retrospect, then, the century from 1870 to 1970 was an atypical interlude in which states enjoyed a near monopoly in currency affairs. This monopoly gave states power vis-à-vis other societal actors in four ways. First, it provided a powerful political symbol, which is one reason why newly independent states today continue to establish distinct currencies despite their reduced economic significance. Second is the opportunity for seigniorage, which can be an important source of revenue for states and, importantly, the opportunity for which is inversely related to the ability of subjects to substitute into another currency. States that control their money can also practice macroeconomic management by manipulating the money supply and the exchange rate—important policy tools, especially in the short run. Finally, by issuing their own currency, states gain power in a negative sense: they avoid dependence on some other source. For these reasons states continue to support the Westphalian conception of one nation, one money, even though today "it is no more than a myth" (p. 46).

Not only is the Westphalian conception of money a myth, but Cohen illustrates that it was an oversimplification even during its heyday. While states had more control over their currencies from 1870 to 1970, they nevertheless routinely chose to abdicate some of that sovereignty, in two ways—either by subordinating or by sharing their monetary sovereignty. States routinely subordinated their sovereignty,

[2] On this point, see Eric Helleiner, "Historicizing Territorial Currencies: Money Space and the Nation-State in North America," *Political Geography* 18 (March 1999).

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choosing policies that range from wholesale abandonment through the adoption of a currency board to the more modest participation in a monetary bloc. States have also chosen to share their monetary sovereignty by forming currency unions, trading some of the benefits of a monopoly over money in exchange for improved autonomy vis-à-vis the outside world, making more efficient use of money (in its classic economic roles) within the monetary union, and forming a broader political symbol. While Cohen's account of these exceptions to the Westphalian myth are interesting in their own right, they are also of increased practical significance, as all states must now weigh their options in the face of reduced monetary sovereignty.

Cohen next offers a rich empirical examination that provides the bridge between the first half of the book, which sets out the argument, and the following three chapters, which explore its implications. Looking at the contemporary global economy, he attempts to assess the extent of currency internationalization and currency substitution, providing support for the assertion that one nation, one money is a myth. "The picture that emerges from this survey is one of intense competition as well as distinct hierarchy among the world's many currencies" (p. 93). Cohen then considers this hierarchy and introduces a new typology, the "Currency Pyramid," to classify the role of different currencies and to help visualize a new landscape in which most currencies face rivals but few are used internationally. Featuring seven categories, ranging from top and patrician currencies all the way down to quasi and pseudo currencies, this typology can be seen as an effort to update Strange's classic descriptions of thirty years ago.[3]

Having established his empirical claim and sketched the new geography of money, Cohen offers three chapters that consider the political implications of the new world: these are the core of what will be the book's most lasting contributions. The first, "A New Structure of Power," revisits the four elements of power—symbolism, seigniorage, management, and insulation—that states derived from issuing currency during the Westphalian era. He asks, "What happens to structures of power when currencies are no longer territorial?" (p. 119). Two themes dictate what is new for each of the four elements. First, the changes will be defined by the new relationships between state and market, not between states. States that are sensitive to market sentiment will be able to retain aspects of the four elements. Second, while all states will find themselves increasingly constrained by the market, those at the bottom

[3] Susan Strange, "The Politics of International Currencies," *World Politics* 23 (January 1971).

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of the pyramid will have fewer options than those at the top. Thus, states will be able to retain the political symbolism to be derived from issuing their own currencies, so long as they manage those issues in an appropriate fashion. Indeed good management, yielding a "strong currency," can "enhance a government's reputation" (p. 121). Similarly, the prospects for macroeconomic management will depend increasingly on "how official policies interact with market preferences" (p. 125). With regard to seigniorage and insulation, the emphasis is on asymmetry: those at the top of the pyramid will find their positions enhanced (so long as they do not drift too far from market preferences), while those at the bottom will lose out. The biggest changes, however, as Cohen reminds us, are not about the differences between states but rather concern the fact that governments in general will have less power in relation to other social actors than they had in the distant past. The big winners politically are those private social actors who can choose their preferred transaction network.

Chapter 7, "Governance Transformed," considers this very question: the role of the state, especially vis-à-vis private actors, in the new monetary landscape. Here Cohen attempts to seize the middle ground. While states are weaker than they once were, they are surely not powerless. His main point is that "the shift in the structure of power generated by cross-border currency competition has not so much diminished as *transformed* the role of the state in money's newly deterritorialized geography. Governance is now uneasily shared between the public and private sectors" (p. 131). Privileged elements in the private sector now have an easier exit option, and governments are under pressure not to provoke such exit. But Cohen argues that this is only part of the picture, because it restricts itself to the demand side of the equation. Governments, as the providers of currency, represent the vital supply side, a role that has not been eliminated by the transformation. Rather, governments have been transformed from monopolists to oligopolists. "States, once largely supreme in their own territories, have now become something like competing firms in an oligopolistic industry" (p. 138). And as oligopolists, governments can act to preserve and promote the market share for their products. Governance, once provided by states, is now in the hands of the market forces that shape the strategies states must pursue in the context of their oligopolistic competition.

Cohen the liberal economist has confidence in the efficiency of market governance, but Cohen the political scientist raises grave doubts about two aspects of the new geography of money. First, there is the problem of equity: some actors will get much more voice in the new

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system, in particular, the wealthiest segments of society. Second, there is a crisis of accountability: however much politicians may be objects of scorn, at the very least they could be held accountable for their actions. Market forces, by contrast, "are neither elected nor politically accountable" (p. 148).

These crucial questions of equity and accountability are not, however, the focus of the final chapter, "Can Public Policy Cope." For this reason, of the three grand chapters that close this book, this one is disappointing in that it does not fulfill the agenda raised by what came before it. Cohen asserts, accurately, that there are "no easy solutions." The bottom line ultimately is that "governments must learn how to *manage* their oligopolistic rivalry, not make futile attempts to evade or suppress it" (p. 151). Cohen then shifts gears and provides an overview of the new monetary landscape, emphasizing that neither a reassertion of state power nor a complete denationalization of money is likely to occur. Rather, exploring each level of the currency pyramid, including the euro, the yen, and the bottom dwellers, he concludes that the world is likely to continue to look pretty much the way it does now: with the gentle erosion of the still dominant dollar tempered increasingly not by competition from the euro or the yen but by the power of markets.

Can the Middle Hold?

Cohen's treatment of money, though politically sensitive and sophisticated,[4] nevertheless represents the economistic pillar of the IPE mainstream. For this branch of the subfield, and especially with regard to the study of money, the use of market metaphors and the assumption of market efficiency must be carefully scrutinized.

The use of economic metaphor is one of Cohen's key contributions. Between Westphalia and globalization, he argues, there is a middle ground of oligopoly—an attractive and novel conceptualization that would appear to strike a clear middle ground between two opposing schools. Issuers of currency can easily be cast as traditional oligopolists.

[4] Cohen notes, for example, that the extent to which the yen is used as an international currency is essentially a policy choice and that both the Europeans and the Japanese manage their currencies with an eye toward avoiding confrontation with the United States (pp. 161, 164). He also assesses monetary geography in its most basic form, sustaining monetary alliances, and finds that economic theory, such as the theory of optimal currency areas, has little explanatory power. Rather, political factors such as power and ideology explain which monetary unions succeed and which fail (pp. 82, 84–85, 87, 91). See also the cases discussed in Cohen, "Beyond EMU: The Problem of Sustainability," *Economics and Politics* 5 (July 1993). He also traces the drive for EMU to political motives, but it should be noted that he reviewed the convergence criteria without a discussion of their possible distributional implications (*Geography of Money,* 74, 77).

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Operating as they do in a world of interdependence and uncertainty, they must focus on promoting their brand name and assuring the market share for their product.

But are the dollar, yen, and euro like Boeing, Coke, and Kodak? In at least one crucial way, the answer is no. It is not the obvious difference between public and private that undermines the analogy but rather the difference between the real and monetary sides of the economy. Boeing, for example, has orders and contracts that will take years to fulfill. It also has physical plants and equipment, technical know-how, and a small number of identifiable competitors. Entry and exit for producers and consumers in the aerospace industry, while certainly possible, is a relatively slow process. Thus, if Boeing has a bad quarter or even a few bad quarters, it may lose some of its market share. But it will lose only so much. There will be no "flight from Boeing" (as it were), even if it faced a great crisis, as might occur if one of its planes were found to have a design flaw.

But currencies are different. Ultimately, they are worth, well, what people think they are worth. And if confidence wavers, people can get rid of that asset and almost immediately acquire any of dozens of alternative assets. Further, those very actions may be self-fulfilling—creating expectations of further flight and a "rational" erosion of confidence. Cohen himself is quite explicit about the ephemeral nature of a currency's attractiveness (p. 97, and also pp. 10–13)—it is attractive as long as it conforms to those policies that the market finds attractive. As Cohen notes, reputation, which comes at "considerable cost and effort," is crucial (p. 141).

But this raises a fundamental point. While the international use of currency may look like an oligopoly (concentrated use in a few brands), this does not mean that the producers enjoy oligopolistic power. What distinguishes oligopolists from other actors in a market economy is that they are not mere "price takers." Rather, they can affect the market and the price for their good—in a much more limited fashion than monopolists, to be sure, but still to an extent that distinguishes them sharply from the textbook firm. But in currency affairs exit is so easy and the extent to which states are adhering to market preferences is so transparent that issuing states in fact may have very little leeway to act as oligopolists.

Cohen's own arguments make this clear. Efforts to protect a currency's reputation will be successful if they "make significant concessions to market sentiment" (p. 122). This is true even for states at the very top of the currency pyramid. Cohen had argued that such states

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could still reap the political benefits afforded by national money, such as seigniorage and the ability to practice macroeconomic management; in both cases such autonomy is circumscribed by the need to "retain competitive superiority in the marketplace" and by "how official policies interact with market preferences" (pp. 123, 135). Thus Cohen's oligopolists may face the constraints of perfect competition.[5]

This is critical for Cohen's analysis, because if the wiggle room of the oligopolist is eliminated, then we must confront the possibility that we are de facto in the purely globalized world where states have no power and markets rule. While Cohen raises political concerns about markets (equity and accountability, as mentioned above), he still holds to a fundamental faith that unfettered market forces will yield optimal outcomes. Smaller states, for example, may achieve "a much healthier economic performance" if they "in effect submit their national sovereignty, at least in part, to the strict discipline of the marketplace" (p. 126).

But what if laissez-faire is suboptimal when it comes to international money? This, one of the fundamental divergences between Cohen and Strange, remains an unresolved question; it will be addressed at length below. Cohen does offer at least one good deductive reason to suspect that unregulated money is not a good idea. He notes, for example, that one technique of bolstering a currency's reputation is to raise interest rates. But in a world of oligopolistic competition, where reputation is relative, this may lead to competitive interest-rate increases—for political reasons, rather than for economic ones.[6] The result—suboptimally high interest rates having no economic justification—would slow global economic activity.

The prospect of flaws in the functioning of the international macroeconomy is the weak link of Cohen's analysis and, by extension, of the study of money from this perspective in the IPE field as a whole. Cohen explicitly embraces the market, and quite pointedly so, explaining that as state power erodes, we are left not with anarchy but with governance by the market. Indeed, responding directly to the assertion by Strange that states have been replaced by anarchy, Cohen answers that "nothing

[5] Cohen recognizes this, explaining that autonomy is likely to erode even for the most powerful states and noting that public policy will have to conform increasingly with what markets want (pp. 130, 133). His faith in market efficiency masks the tension between these observations and his oligopoly analogy.

[6] For an illustration of the potentially disastrous consequences of interest-rate competition, derived in part from a concern with market reputation, see Barry Eichengreen, *Golden Fetters: The Gold Standard and the Great Depression* (Oxford: Oxford University Press, 1992). See also Jonathan Kirshner, "Disinflation, Structural Change, and Distribution," *Review of Radical Political Economics* 30 (March 1998).

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could be more mistaken" (p. 142). The market, like the state, according to Cohen, is a socially constructed system of authority. Thus, governments have been replaced "not by anarchy but by the invisible hand of competition" (p. 146).[7]

For scholars raised on a steady diet of IR theory, this will be the one awkward moment of the book. For while markets may be socially constructed, once formed they do create an anarchic environment—that is, an environment that lacks central authority. In its purest form, while "the market" is the result of the sum of actions taken by individual actors, those actions combine to create constraints on each one that no single actor can affect. It is this very market analogy and the appeal to anarchy that was the foundation of Kenneth Waltz's defense of systemic theorizing in international politics.[8] Additionally, the implicit appeal to Adam Smith in this argument is also problematic, because Smith did not believe that all monetary matters should be left to the market. He supported, for example, regulations to control interest rates.[9]

Thus, despite Cohen's thoughtful ruminations on the nature of "governance," it is hard to avoid the conclusion that as state power erodes, we are left increasingly to anarchic (though not necessarily chaotic) market forces. As noted, Cohen sees political consequences flowing from this change; such an arrangement, he states, faces a "crisis of legitimacy" (p. 147). But ultimately, a basic faith in the market underpins *Geography* and that branch of the subfield which it ably represents.

A Mad, Mad World

Susan Strange's *Mad Money*, like Cohen's volume, is a major statement that integrates the accumulated knowledge of a foremost scholar of the IPE of money. But beyond that, the similarities end. Even as Cohen refines themes and applies them in different contexts, *Geography* nonetheless reflects more continuity than change. *Mad Money*, by contrast, completes a transition in Strange's work. Her early efforts, such

[7] In a parallel argument to his oligopoly metaphor, Cohen argues, with an appeal to Alfred Marshall, that governance that emerges from the market reflects the outcome of both demand and supply-side forces. But, following Marshall, it is the shape of the curves that is determinant. If the demand curve takes the shape of a flat line (is infinitely elastic), then supply has no voice in determining the equilibrium price.

[8] Waltz, *Theory of International Politics* (New York: Random House, 1979). Interestingly, an outstanding application of systemic theorizing that illustrates the consequences of anarchy can be found in Benjamin Cohen, *The Question of Imperialism* (New York: Basic Books, 1973).

[9] Smith, *The Wealth of Nations* (1776; Chicago: University of Chicago Press, 1976), 379–80.

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as the seminal *Sterling and British Policy*, as well as *International Monetary Relations, 1959–1971*, were market sensitive but statecentric. Later, in books like *Casino Capitalism* and *Rival States, Rival Firms*, market forces unleashed by states became the principal constraint upon individual governments and posed the most basic challenges to them. Finally, at the close of her career, in *The Retreat of the State* and with the publication of *Mad Money*, those market forces have triumphed.

Mad Money also differs from *Geography*, as noted above, in its much deeper skepticism of the consequences of those unleashed forces. Strange's perspective, not surprisingly, is also more overtly political: actors often have sharp, conflicting motivations, and political variables figure prominently in the foreground. The books are stylistically distinct as well. While Cohen constructs a careful, linear argument, Strange's book lays out its principal theme and then embarks on a thematic survey of the global terrain.

The title itself captures her argument. Why *mad* money? Because the definition of mad is "wildly foolish," and this is the proper way to characterize the decision "to let the financial markets run so far ahead, so far beyond the control of state and international authorities" (p. 1). Financial markets themselves have also turned out to be "mad": erratic, unpredictable, and dangerous. Strange observes pathological behavior, and her first two chapters thus diagnose the problem. Increases in the size of financial markets and the speed of financial transactions, along with the decrease of national and international supervision and regulation of banking and financial services, have resulted in a global financial system even more fragile and volatile than the one she described in *Casino Capitalism*. Strange then traces the series of decisions (and nondecisions) made by states that allowed these changes to occur. In her assessment, the fact that markets have outgrown governments is "*the* prime issue of international politics and economics" (p. 18, emphasis in original).

Strange's next two chapters focus on the political foundations of the international financial system. First is the crucial bilateral relationship between the United States and Japan: she sees reduced likelihood that the needed political cooperation between the world's two largest economies will take place. This discussion includes, in distinct sections, the most dated and the most farsighted analysis of the volume. The sources of tension are mainly the usual suspects from the late 1980s, when the end of the cold war, the surging Japanese economy, and enormous American budget deficits fostered an atmosphere of growing sus-

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picion between the two states.[10] But on the heels of this review comes a broader discussion of the importance of international cooperation and its political underpinnings. For when crises occur, as they inevitably will, swift intervention is needed on the part of governments, not bankers. Central banks are ill-suited to the task, as they "have an innate tendency to prefer deflation to inflation, and to judge monetary stability more important than keeping people in jobs and troubled businesses from closing down" (p. 58). Here Strange explicitly invokes Keynes, praising his emphasis on the real side of the economy, in contrast with the deflationists of the interwar years.[11]

The second political foundation considered by Strange is the relationship between France and Germany. Politics—"the domestic politics of France and Germany and the impact of both on the relations between them" (p. 60)—will ultimately decide the fate of the euro. While international politics—the end of the cold war liberating German foreign policy from its dependence on America—has allowed the euro to come about, politics will also assure that it will be a continuing source of instability. On the road to unification the uncertainty that necessarily accompanies politics will result in recurrent bouts of speculative pressure. Afterward, because the European Union's political structure is not up to the task of managing the political conflicts that will emerge over the management of a common currency, the great European monetary project will struggle at first and then most likely fail.

From this perspective—shaped by the rise of mad money and the decline of international political cooperation—Strange moves on in the middle of the book to survey a number of disparate issues, such as stock market speculation, debt crises, and transnational organized crime. These issues are unified, however, by the consistent analytical perspective of "global Keynesianism." Strange never declares this, but her loyalties are unambiguous. Thus in one instance she characterizes a writer as a global Keynesian and then later notes that his position "echoes [her] own argument" (p. 14). She also goes out of her way repeatedly to praise Keynes's work and track record, and she champions policy prescriptions that are explicitly and implicitly associated with him.[12]

[10] It should be noted that Strange does touch on some more recent developments, such as the increased concentration of savings in Japan's postal savings system and the shift in the composition of Japan's U.S. holdings from long-term securities to short-term Treasury bills (p. 50).

[11] Strange also argues that protectionism and trade blocs are normally the result, not the cause, of economic distress, which can usually be traced to the financial system. As such, she contends, relatively too much attention has been given to the politics of trade (p. 58, see also pp. 87, 186).

[12] See, e.g., pp. 16, 88, 90, 92, 120, 183. These themes were repeated in one of Strange's last works, where she addressed the "most amazing omission" in contemporary IPE scholarship, the work of

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One of the principal problems of the contemporary global economy, Strange argues, is the pressing need to apply Keynesian policies at a time when it is exceptionally difficult to implement them. This is because Keynes's "great work," *The General Theory*, provided a template for the management of national economies that are, if not closed, at least relatively insulated. Such a world no longer exists, however, due in large measure to the (ill-advised) dismantling of the capital controls that most states deployed during the Bretton Woods era.[13] (Recall that Keynes, one of the principal architects of the Bretton Woods system, wrote: "Nothing is more certain than that the movement of capital funds must be regulated.")[14]

Thus, by the mid-1980s "the logic of the *General Theory* still held. But henceforth if countercyclical intervention were to be effective, it would have to be global and collective, not national" (p. 91). Not only is the cooperation needed for such collective action less likely, however, but few powerful states or institutions have the inclination to support such policies anyway. Big countries like the United States see too few short-run interests at stake to justify the effort, while the IMF's philosophy is "monetarist rather than Keynesian, anti-inflationary, opposed to fiscal deficits, state ownership, and welfare subsidies" (p. 93). Because of this, the world has collectively botched the transformation of the former Soviet bloc and the management of the Mexican and Asian financial crises, at great real cost and with lasting and substantive consequence.[15] Relatedly, the orthodox treatment of financial crises in general is inadequate, since it focuses solely on the domestic economies of the states involved and not on the crucial international mechanisms through which financial panics can be fomented, exacerbated, transmitted.[16]

Keynes. See Susan Strange, "Finance in Politics: An Epilogue to *Mad Money*" (Draft paper prepared for *Power and Order: Change in World Politics—A Festschrift in Honor of Robert G. Gilpin*, Princeton University, October 2–3, 1998), 7 and the discussion on 8–9. See also Jonathan Kirshner, "Keynes, Capital Mobility, and the Crisis of Embedded Liberalism," *Review of International Political Economy* 6 (Autumn 1999).

[13] Obviously, the folly of capital deregulation is one of the main themes of Strange's book. See for example pp. 16–17; also idem (fn. 12), 6, 17–18.

[14] John Maynard Keynes, "Letter to Roy Harrod," April 19, 1942, reprinted in Donald Moggridge and Elizabeth Johnson, eds., *The Collected Writings of John Maynard Keynes* (London: Macmillan, 1971–89), 25:149.

[15] See pp. 103–6, 109–11, 118–20, and note especially Strange's distinction between nominal recovery, "the restoration of confidence in financial markets" (p. 105), and the performance of the real economy.

[16] See pp. 106, 112. Strange's perspective on the tendency for international financial instability and the need for international governance is similar to Kindleberger's, whom she also cites repeatedly and approvingly. See pp. 15, 55–56, 86; also Charles Kindleberger, *The World in Depression*, rev. and expanded ed. (Berkeley: University of California Press, 1986); and especially idem, *Manias, Panics, and Crashes*, 3d ed. (New York: Wiley, 1996).

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Finally, neither of the two potential "international guardians" appears poised to save the day. Indeed, the Bank for International Settlements, while still a vital forum for communication between central banks, has "abandoned, in effect, the whole idea of agreed common standards of banking supervision" (p. 161). Nor is the IMF, even disregarding the criticisms raised elsewhere in the volume, up to the task. On the contrary, as it faces greater problems, ever larger bailouts, and, importantly, declining legitimacy, Strange finds a "chilling analogy with the U.S. experience in Vietnam," with the fund "biting off more than it can chew" (p. 164).

In looking out the window, Strange sees much the same world that Cohen describes. At century's end "the nation state is not up to the job of managing mad international money" (p. 190) and has been superseded by an increased "reliance on the discipline of market forces" (p. 176). And like Cohen, Strange argues that this will empower some at the expense of others: in a world dominated by vast international credit markets large firms and large states will do better than small firms and small states.

But for Strange, the problems run much deeper. Unlike Cohen she does not view laissez-faire in money and finance as economically efficient. Its pathologies run both hot and cold, and Strange envisions two potential paths by which mad money could lead to a global economic crisis. First by fire: irrationality, rooted in greed and fear (the "emotions most prevalent in the day to day behavior of the international financial system today" [p. 139]) and perhaps goaded by political instability in Russia or China unleashes a financial panic that a sluggish political response fails to contain. Or second by ice: an exogenous contraction of credit, exacerbated by "the deflationary bias of monetarist economic strategies . . . land the world production and trade structures in a vicious circle of falling demand" (p. 185) that, again, is inadequately contained. Either way, mad money will come to no good. The only silver lining is that when a major crisis does occur, it will probably provide the necessary impetus for fundamental reform.[17]

The Road from Here

The great strengths of *Mad Money* lie in its diagnosis of the problem and the way that its infusion of politics animates each discussion. But Strange does not advance any specific theoretical apparatus and is cau-

[17]See, e.g., pp. 168, 190.

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tious about making predictions. She is also quite realistic—that is, pessimistic—about the political prospects for "global Keynesianism" and offers few details as to how it would be managed in practice.[18] As a result, to an even greater extent than *Geography*, the book raises more questions than it answers.

But if Strange and Cohen do not provide the answers, they do offer guidance for those who would follow in their footsteps. While both *Geography* and *Mad Money* suggest dozens of avenues for investigation, there is one recurrent theme that points to a clear research trajectory. The implicit and to a large extent unintentional fulcrum of these books is the theme of a distinct relationship between ideas, institutions, and interests in the monetary sphere. A closer look at ideas about money leads ultimately to the study of conflict over money and from there more broadly to the politics of money. The following discussion, therefore, unfolds in four linked and interrelated stages. First, the profound significance of ideas in monetary affairs is considered, both for authors' perspectives and for the discipline as a whole. Crucially, ideas about money can have an independent effect not only on which policies will be chosen but also upon which types of policies will be successful. The discussion then turns to why this matters: even if monetary phenomena are neutral (with no long-run influence on aggregate economic performance), they can and typically do have sharp distributional effects. Thus many economic policies that are justified principally on the strength of their theoretical soundness (and superiority to other options) may be of predominantly political origin and effect. Two examples—inflation and capital mobility—are then introduced to illustrate this point. In each case, ideas have played a crucial role in shaping and sustaining one policy option, even though the evidence suggests that the economic distinctions between competing policies are relatively small and ambiguous, while the political consequences appear sharp and substantial.

Ideas: More Than You Think

There is an important and growing literature on the importance of ideas in international relations, as well as in IPE, including some works that have addressed how ideas have shaped decisions made about

[18] One exception is her repeated plea for the closure of tax havens, one measure at least that should be feasible. See pp. 131, 188–89. On Strange's caution about efforts to make specific predictions in IR, see pp. 19–20, 179.

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money.[19] But there is something special about the role of ideas in monetary affairs that has not been sufficiently addressed to this point: with regard to money, the power of ideas does more than just shape the possible—it defines the feasible.

At one level *Geography* embraces the power of ideas. Early in the volume Cohen reaches out to the constructivists and explores the indispensable social foundations of money. "The key to all three of money's roles is trust" (p. 11), the roots of which, with regard to money, "are in fact many and to some extent mysterious" and reflect "all manner of social beliefs and influences" (p. 12). But Cohen's primary interest is to challenge the reader's imagination and open the door to his new representation of the geography of money. Once this is established, the constructivists are left behind. However, the crucial role of ideas remains a latent foundation of the volume. "[N]othing enhances a currency's acceptability more than the prospect of acceptability by others" (p. 97), he observes. But what is the source of this acceptability?[20] Recall Cohen's admonition that states, even at the top of the currency pyramid, must "make significant concessions to market sentiment" (p. 122). This theme is ubiquitous and emerges at crucial moments: "The issue, ultimately, is a government's own credibility" (p. 67). The U.S. must pursue "credible strategies," and over time the euro might thrive if it can establish "credibility and confidence" (pp. 156, 160). In all cases success hinges on "how credible a government's maneuvers turn out to be" (p. 121).

Credible policies are ultimately those that "the market" thinks are the right policies. Cohen realizes that policies that are not credible cannot be sustained, but he is confident that the market is "right" about matters of economic efficiency. Hence he does not dwell on the point. Strange once again shares Cohen's assessment but, again, not his confidence. As a result, her discussion of ideas is more pointed. She suggests that the market's preferences can be arbitrary and argues that the particulars of government policy are less important than the market's per-

[19] See, for example, Judith Goldstein, *Ideas, Interests and American Trade Policy* (Ithaca, N.Y.: Cornell University Press, 1993); Judith Goldstein and Robert Keohane, eds., *Ideas and Foreign Policy* (Ithaca, N.Y.: Cornell University Press, 1993); Peter Haas, ed., "Knowledge, Power, and International Policy Coordination," special issue of *International Organization* 46 (Winter 1992); John S. Odell, *U.S. International Monetary Policy* (Princeton: Princeton University Press, 1982); Joanne Gowa, *Closing the Gold Window* (Ithaca, N.Y.: Cornell University Press, 1983); Kathleen McNamara, *The Currency of Ideas* (Princeton: Princeton University Press, 1998); Eric Helleiner, "National Currencies and National Identities," *American Behavioral Scientist* 41 (August 1998).

[20] Cohen refers here specifically to the reason why the currencies of large, internationally integrated economies are often attractive to others. But the point is general and inseparable from the issue of credibility, a ubiquitous theme that Cohen rejoins in the subsequent paragraph. Regarding acceptability, one cannot help but be reminded of Sidney Greenstreet's line in *The Maltese Falcon*: "I'll tell you right out, I'm a man who likes talking to a man who likes to talk."

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ception of them. There is little doubt that economic ideology is used "to veil the conflict between special and national interests."[21] But while Strange raises these issues repeatedly, she does not explore them systematically, perhaps because to her they seem so obvious as to require little elaboration. Ironically, this perspective provides one of the few sources of optimism in *Mad Money*. For if ideas are arbitrary or, at least, if there are competing belief systems, each of which may hold sway during one period or another, then perhaps there is hope for the future. The "apparent worldwide victory of neo-liberal ideas in economics over Keynesian ones" need not be permanent. "The open question that remains is about people's ideas and beliefs. That is always the key to political and therefore economic change" (pp. 183, 182).[22]

The role of beliefs and ideas in macroeconomics is unique, therefore, in that all macroeconomic policies require public confidence in order to work. The astonishing result of this is that on a hypothetical menu of five economic policies, each of which was plausible from the standpoint of economic theory, if three were *perceived* to be illegitimate, they would not in fact be sustainable, *solely for that reason*. Support for this constructivist proposition can be found in the halls of the University of Chicago economics department. In their classic *Monetary History of the United States*, Milton Friedman and Anna Schwartz argue that abandoning the gold standard "might well have been highly preferable" for the U.S. in the 1890s. However, in a "fascinating example of how important what people think about money can sometimes be," that choice was not feasible. Instead, "the fear that silver would produce an inflation sufficient to force the United States off the gold standard made it necessary to have a severe deflation in order to stay on the gold standard." To some extent, then, the art of the feasible is both contestable and consequential.[23]

This phenomenon is not just an artifact of history but continues to have a profound influence on both economic theory and the practice of public policy. One of the reasons states abandoned the Bretton Woods fixed-exchange-rate system was the expectation that flexible-exchange-rate systems would afford macroeconomic policy autonomy. This was an implication of the influential Mundell-Fleming model, which re-

[21] Strange (fn. 12), 15.

[22] On perception versus reality, see, e.g., p. 107. For more on ideas, mood, and sentiment, see pp. 99, 108, 111, 121.

[23] Milton Friedman and Anna J. Schwartz, *A Monetary History of the United States, 1857–1960* (Princeton: Princeton University Press, 1963), 111, 133; see also Ilene Grabel, "Creating 'Credible' Economic Policy in Developing and Transitional Economies," *Review of Radical Political Economics* 29, no. 3 (1997).

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mains an essential analytical device for students of the international economy and of IPE. One of the understood "laws" of economic theory derived from Mundell-Fleming is that states could select only two items from the following menu: free capital flows, fixed exchange rates, and autonomous monetary policy.[24] Thus it was assumed that by abandoning fixed rates, states could pursue the monetary policies of their choice. But this did not turn out to be the case. In theory, given flexible rates, policy disparities should be mediated at the border. If a state's policies resulted in an inflation rate that was 5 percent above the international average, its currency would depreciate by 5 percent and that would be that. But if capital mobility is accompanied by a consensus with regard to what is a "correct" monetary policy, then the depreciation will not stop at 5 percent. Capital flight in this case will punish the state for pursuing a deviant policy. Failure to reverse that policy in the wake of a sustained depreciation will stimulate even further capital flight and depreciation, and so on. Thus a state that preferred to pursue a more expansionist monetary policy than average, even one that was willing to tolerate the depreciation necessary to restore equilibrium in international prices, may be unable to chart such a course in the face of punishing (as opposed to equilibrating) capital flows. Thus the "holy trinity" is a myth. If there is an ideological consensus regarding macroeconomic policy, it is not possible to have capital mobility and policy autonomy at the same time.

Why does this matter? Because macroeconomic policies are often cloaked in the veil of economic legitimacy. Legitimate policies thrive, it is argued, because they are the most efficient. Those that deviate lose out in a Darwinian struggle—they fail because they are unable to deliver the goods. But two observations raise fundamental questions about this version of events. First, as Friedman and Schwartz argued with regard to the choice of a monetary standard, some policies, perhaps even the best policies, may be unsustainable solely because people (erroneously) think they are inefficient. Thus "legitimacy" does not inevitably yield optimality but is instead a path-dependent self-fulfilling prophecy.[25] Second, close examination reveals that for many macro-

[24] Peter B. Kenen, "Macroeconomic Theory and Policy: How the Closed Economy Was Opened," in Ronald W. Jones and Peter B. Kenen, eds., *Handbook of International Economics*, vol. 2 (Amsterdam: North-Holland, 1985); J. M. Fleming, "Domestic Financial Policies under Fixed and under Floating Exchange Rates," *IMF Staff Papers* 9 (November 1962); Robert Mundell, "The Monetary Dynamics of International Adjustment under Fixed Capital," *Quarterly Journal of Economics* 74 (May 1960).

[25] This does not mean, it should be added immediately and emphatically, that any policy is just as good as another. Rather, the argument is solely that there is a plausible set of macroeconomic policies that would provide roughly similar aggregate economic performance and that should be sustainable based on their internal logic.

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economic policy choices, the aggregate economic benefits of choosing one course of action over another are ambiguous, modest, and dwarfed by their political and differential effects.[26]

Ideas matter, then, because they can be crucial in determining which policies from the plausible set will be coronated. The aggregate economic consequences of this choice are not likely to be large. But political consequences—which groups, sectors, regions, and so on, are better off with one policy as opposed to another—may be profound. Closer attention to the relationship between ideas and interests is of course in order. Even more importantly, this suggests that students of the *politics* of money need to reconsider their conceptualization of macroeconomics. In particular, students of politics need to place greater emphasis on the differential as opposed to aggregate effects of macroeconomic phenomena. This will require renewed attention to avenues of inquiry in macroeconomic theory that are not emphasized in contemporary economics.

Macroeconomics, Micropolitics

Modern macroeconomic theory assumes aggregate monetary neutrality, that monetary phenomena do not affect the overall performance of the real economy in the long run. This is not an unreasonable assumption for a discipline concerned with long-run aggregate economic growth.[27] But it provides an inappropriate point of departure for most inquiries into politics. Because even if it is true that monetary phenomena do not affect aggregate economic performance in the long run, they do have real distributional economic effects: shaping relative prices, income distribution, and the relative performance of different sectors and industries across the economy.

[26]As Cohen notes, economic efficiency does not explain the most basic contours of the geography of money. While there are theories of "optimal currency areas," it is clear that the use of money is defined by political concerns. Externally the politics of monetary integration cannot be divorced from international politics. Internally the aggregate benefits of such measures, such as the reduction in transaction costs are surely dwarfed by the differential effect that they will have on various groups. See Cohen, *Geography*, 83–84; also Barry Eichengreen and Jeffry Frieden, "The Political Economy of European Monetary Unification," *Economics and Politics* 5, no. 2 (1993). Similarly, it should also be noted that the choice of the adjustment mechanism is made from a range of options with minor differences in their relative efficiency but profound variation in their political consequence. See, for example, Beth Simmons, *Who Adjusts?* (Princeton: Princeton University Press, 1994).

[27]On monetary neutrality, see Robert Lucas, "Nobel Lecture: Monetary Neutrality," *Journal of Political Economy* 104 (August 1996); Milton Friedman, "The Quantity Theory of Money," and Don Patinkin, "Neutrality of Money," both in John Eatwell, Murry Milgate, and Peter Newman, eds., *The New Palgrave: Money* (New York: Macmillan, 1989); Frank Hahn, *Money and Inflation* (Cambridge: MIT Press, 1983), esp. 38–42, 61; Douglas Gale, *Money: In Equilibrium* (Cambridge: Cambridge University Press, 1982), esp. 13–15, 53.

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The effect of monetary phenomena on relative prices has been recognized even by those economists who were passionate defenders of aggregate monetary neutrality. Irving Fisher, the patriarch of American monetarism, described his opus, *The Purchasing Power of Money*, as "at bottom simply a restatement of the old 'quantity theory of money.'" Yet he also argued that "prices do not, and in fact cannot, move in perfect unison." Rather, aggregate monetary neutrality holds because there exists "a compensation in price movements in the sense that the failure of one set of prices to respond to any influence on the price level will necessitate a correspondingly greater change in other prices."[28] Fisher (and other macroeconomists), then, did not deny the existence of distributional effects; rather, those effects were simply not the object of their study.

Contemporary macroeconomic theory imposes strict assumptions of homogeneity on its models, and these eliminate the issue of distribution from the study of monetary phenomena.[29] This was not always the case. Classical economists, including "virtually all" of the quantity theorists of the late nineteenth century, believed that monetary phenomena have significant real consequences.[30] The main student of these phenomena was Richard Cantillon, whose eighteenth-century writings produced a research agenda that was sustained until the 1930s. Cantillon argued that changes in the money supply did not descend uniformly from heaven but had to flow from some particular source. The nature of the source and the recipients of the money would determine the distinct effect of a change in the money supply. Following a monetary expansion, the price level will rise, but not uniformly, due to the different tastes and elasticities of those who receive the new money first.[31]

Whereas Cantillon says that "everybody agrees that the abundance of money or its increase in exchange raises the price of everything." He adds, crucially, that "market prices will rise more for certain things than

[28] Irving Fisher, *The Purchasing Power of Money*, rev. ed. (New York: Macmillan, 1920), vii, 196, 197.

[29] See, for example, Olivier Blanchard and Stanley Fischer, *Lectures on Macroeconomics* (Cambridge: MIT Press, 1989).

[30] David Laider, *The Golden Age of the Quantity Theory of Money* (Princeton: Princeton University Press, 1991), 17. Malthus, for example, argued that it "must always be recollected" that real effects of monetary expansion are the result not of "the *quantity* of the circulating medium . . . but the *different distribution* of it." T. R. Malthus, "Depreciation of Paper Money," *Edinburgh Review* 17, no. 34 (February 1811), in Bernard Semmel, ed., *Occasional Papers of T. R. Malthus* (New York: Burt Franklin, 1963), 96.

[31] Michael Bordo, "Some Aspects of the Monetary Economics of Richard Cantillon," *Journal of Monetary Economics* 12 (August 1983), esp. 242–43; Douglas Vickers, *Studies in the Theory of Money, 1690–1776* (Philadelphia: Chilton Company, 1959), esp. 189, 206, 208. For more on Cantillon, see Antoin E. Murphy, *Richard Cantillon: Entrepreneur and Economist* (Oxford: Clarendon Press, 1986); Henry Higgs, "Richard Cantillon," *Economic Journal* 1 (June 1891); and also Joseph Spengler, "Richard Cantillon: First of the Moderns," *Journal of Political Economy* 62 (August 1954) and 62 (October 1954).

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for others however abundant the money may be." There are real distributional effects as monetary phenomena work their way through the economy, just as "a river which runs and winds about in its bed will not flow with double the speed when the amount of water is doubled."[32]

Cantillon's work was followed in the nineteenth century by John E. Cairnes and in the twentieth by John Maynard Keynes.[33] Keynes, in his *Treatise on Money*, followed Cantillon and Cairnes with his argument that changes in purchasing power that result from monetary contractions or expansions are "not spread evenly or proportionately over the various buyers." The "new distribution of purchasing power" will have "social and economic consequences" that "may have a fairly large lasting effect on relative price levels." Once again, the argument here is not that monetary disturbances affect aggregate output; rather, it emphasizes the consequences of monetary phenomena even in the absence of such effects. "The fact that monetary changes do not affect all prices in the same way, to the same degree, or at the same time, is what makes them significant."[34]

Ironically, it was subsequent work by Keynes that led to the atrophy of this line of inquiry. In *The General Theory* (1936), which dominated the profession for a generation and ushered in the era of modern macroeconomics, Keynes shifted his emphasis away from monetary influences. The vigorous monetarist response that followed kept the arena of the debate where it was, at the aggregate level.[35] But students of the politics of money need to revisit and build upon the insights of this literature, which was not superseded but rather was left to atrophy, as the focus of the economics profession followed an alternative trajectory. It is the differential, political effects of macroeconomic phenomena that

[32] Richard Cantillon, *Essai sur la nature du commerce en général*, ed. and trans. Henry Higgs (1931; New York: Augustus Kelley, 1964), 161, 179, 177. For practical illustrations of distribution effects, see pp. 163, 165. W. Stanley Jevons characterized Cantillon's tracing of monetary disturbances as "marvelous." See Jevons, "Richard Cantillon and the Nationality of Political Economy," *Contemporary Review* 39 (January 1881), 72. It is important to note that Cantillon was no monetary crank; in fact, he was quite orthodox. He did not believe that a monetary expansion would increase economic activity in the long run. Rather, he was an opponent of inflation who believed that the inflationary process would have self-reversing effects with attendant real economic costs. And he was sensitive to the danger that macroeconomic policy might be manipulated by politicians for their own benefit. See Cantillon, p. 323; also Vickers (fn. 31), 212, 216; Bordo (fn. 31), 237, 251; Murphy (fn. 31), 263, 277.

[33] John E. Cairnes, *Essays in Political Economy: Theoretical and Applied* (1873; New York: Augustus Kelley, 1965), esp. 9, 10; also Michael Bordo, "John E. Cairnes on the Effects of the Australian Gold Discoveries, 1851–73," *History of Political Economy* 7 (Fall 1975).

[34] Keynes, *A Treatise on Money I: The Pure Theory of Money* (1930), in Moggridge and Johnson (fn. 14), 5:81, 83–84.

[35] See Perry G. Mehrling, *The Money Interest and the Public Interest: American Monetary Thought, 1920–1970* (Cambridge: Harvard University Press, 1997); and Charles Rist, *History of Monetary and Credit Theory: From John Law to the Present Day*, trans. Jane Degras (1940; New York: Augustus M. Kelley, 1966), esp. 148, 375.

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provide the missing link in the relationship between ideas and interests and clarify the extent to which the choice of a "legitimate" economic policy may be of greater political than economic consequence.

This can be illustrated with two policy examples—one regarding inflation management and the other, capital mobility—that are of great practical importance and contemporary salience. In each case, one policy has a sole, consequential, and self-reinforcing claim to economic legitimacy. But in each case there are also alternative policies that from an economic perspective are equally plausible. Despite their internal consistency, however, they are virtually unsustainable solely because they lack legitimacy. What matters here is not the policy choice per se—as just noted, either is plausible—but rather the way in which the winning policy is anointed. Stripped of their rhetorical dressing, the aggregate economic distinctions between competing policies are ambiguous and modest and dwarfed by their differential effects. Narrow political interests better account for the path chosen.

Imagine Low Inflation

A dramatic example of the extent to which economic legitimacy cloaks profound political consequences can be seen with the hegemonic proposition that vigilance against the threat of inflation must be the primary, if not the sole, goal of macroeconomic policy. This view derives from the recognition, supported by evidence, that governments cannot call forth greater employment and production in the long run via monetary expansion. But the only conclusion that can be drawn from this is that governments should not purposefully promote inflation to expand output. It does not address the question of whether inflation itself is costly or "bad" or whether suppressing inflationary embers need be the principal goal of policy.

There are many deductive reasons why inflation might impose real economic costs, and models can be constructed to simulate why inflation should be costly in practice. Inflation, for example, can weaken the informational role of prices. This can also reduce efficiency by increasing uncertainty. There is empirical support for these propositions, as inflation has been shown to be associated with greater variability in prices and the variability of real output. Inflation, as a tax on cash balances, also carries with it the inefficiencies associated with excise taxes.[36]

[36] For a summary of possible costs, see Stanley Fischer and Franco Modigliani, "Toward Understanding of the Real Effects and Costs of Inflation," in Fischer, *Indexing, Inflation, and Economic*

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There are, however, competing arguments that provide reasons why some inflation might actually be a good thing (that is, the inflation rate associated with the maximum possible rate of economic growth is positive). Such arguments often center around the view that in an economy where nominal prices are sluggish to adjust downward, some inflation would allow changes in relative prices, an essential feature of any growing economy, to occur faster and more efficiently. In fact, "inflation may be a necessary part of the process," and deductive models can be constructed and simulations run to show that in fact moderate inflation "permits maximum employment and output."[37]

Given the indeterminacy of deductive arguments and the relative abundance of data on inflation rates and growth rates, the obvious next step is to evaluate the evidence. In fact, the costs of moderate inflation are extraordinarily difficult to find. Inflation hawk Robert Barro, who had previously written that while economists assume that inflation is costly, they "have not presented very convincing arguments to explain these costs,"[38] attempted to illustrate those costs in two recent papers. He concludes that the data reveal costs that seem small yet have a cumulative effect that is "more than enough to justify a strong interest in price stability." He notes, however, that the "clear evidence" of the costs of inflation come from countries that have had inflationary episodes exceeding 10–20 percent per year. The qualifications are even stronger in his follow-up paper: "For inflation rates below twenty percent per year . . . the relation between growth and inflation is not statistically significant."[39]

Policy (Cambridge: MIT Press, 1986). On information, see Gardner Ackley, "The Costs of Inflation," *American Economic Review* 68 (May 1978). On variability, see Richard W. Parks, "Inflation and Relative Price Variability," *Journal of Political Economy* 86 (February 1978). On cash-balance effects, see Martin J. Bailey, "The Welfare Cost of Inflationary Finance," *Journal of Political Economy* 64 (April 1956). Deductive models that can yield high costs of inflation include Michel Dotsey and Peter Richmond, "The Welfare Cost of Inflation in General Equilibrium," *Journal of Monetary Economics* 37 (February 1996); and Martin Feldstein, "The Welfare Cost of Permanent Inflation and Optimal Short-Run Economic Policy," *Journal of Political Economy* 87, no. 4 (1979).

[37] James Duesenberry, "Inflation and Income Distribution," in Eric Lundberg, ed., *Inflation Theory and Anti-Inflation Policy* (Boulder, Colo.: Westview Press, 1977), 265 (first quote); George Akerlof, William Dickens, and George Perry, *The Macroeconomics of Low Inflation*, Brookings Papers on Economic Activity, no. 1 (1996), 2 (second quote). Very low inflation also might undermine monetary policy, given a nominal interest-rate floor of 0 percent.

[38] Robert J. Barro and David B. Gordon, "Rules, Discretion, and Reputation in a Model of Monetary Policy," *Journal of Monetary Economics* 12 (February 1983), 104.

[39] Robert J. Barro, "Inflation and Economic Growth," *Bank of England Quarterly Bulletin* 35 (May 1995), 1, 9; and idem, "Inflation and Growth," *Federal Reserve Bank of St. Louis Review* 78 (May–June 1996), 159. Critics of these papers have challenged Barro's policy prescriptions. W. Stanners argues that even the "weak conclusion" of the first paper "cannot be sustained." Stanners, "Inflation and Growth," *Cambridge Journal of Economics* 20 (July 1996), 511, also 512. In commentary following the second paper, Kocherlakota Narayana argues that "I would recommend that policymakers *not* view lower long run growth as a penalty of inflationary monetary policy" (p. 172).

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Almost all of the negative relationships found between inflation and growth are dependent on the consequences of very high levels of inflation.[40] Ultimately, any real economic costs of inflation, especially inflation below 20 percent and certainly below 10 percent, are almost impossible to show. While one study has claimed to demonstrate that inflation over 8 percent is costly (with inflation below 8 percent having a slight positive effect), another study claims to produce "direct evidence against the view that inflation and output growth are reliably related in the long run."[41] But even studies that manage to show some relationship between inflation and growth need to be interpreted very cautiously.[42]

For those who study the politics of money, the final resolution of this debate is not of great concern. The evidence overwhelmingly supports the view that inflation rates at low or moderate levels have very little effect on the performance of the aggregate economy. This casts new light on the long-held understanding that inflation has distributional consequences[43] and on the less appreciated but just as important observation

[40] Two prominent examples of this would be Stanley Fischer, "The Role of Macroeconomic Factors in Growth," *Journal of Monetary Economics* 32 (December 1993); and Michael Bruno, "Does Inflation Really Lower Growth?" *Finance and Development* 32 (September 1995), 35, 38. Yet Bruno and Fischer each support policies designed to keep inflation very low. See Fischer, "Maintaining Price Stability," *Finance and Development* 33 (December 1996), 34–37; Michael Bruno and William Easterly, "Inflation and Growth: In Search of a Stable Relationship," *Federal Reserve Bank of St. Louis Review* 78 (May–June 1996), 145.

[41] Michael Sarel, "Non-linear Effects of Inflation on Economic Growth," *IMF Staff Papers* 43 (March 1996); James Bullard and John W. Keating, "The Long-Run Relationship between Inflation and Output in Postwar Economies," *Journal of Monetary Economics* 36 (December 1995), 495. Bullard and Keating also note some positive effects: "To the extent that we do find statistically significant estimates, they tend to be positive, with a permanent increase in inflation being associated with a permanent increase in the level of output" (p. 494).

[42] First, the findings of studies showing relationships between inflation (and other macroeconomic variables) and growth are quite fragile. See Ross Levine and David Renelt, "A Sensitivity Analysis of Cross-Country Growth Regressions," *American Economic Review* 82 (September 1992). Second, inflation, especially high inflation, might be associated with lower economic performance because high inflation might be a symptom of government incompetence. In this case, the inflation could be a symptom of government-inhibited growth rather than a cause. This is recognized by Fischer (fn. 40, 1993), 487. Third, as Bruno notes (fn. 40), an association of inflation with growth could be the result of other factors, such as supply shocks, that would affect both factors simultaneously (p. 35).

[43] Few would dispute the notion, for example, that unanticipated inflation benefits debtors at the expense of creditors or that governments often use inflation as a means of increasing their resources relative to society. In fact, inflation affects distribution through a multitude of channels, with differential effects on various individuals, classes, sectors, and regions.

Empirical investigations into the effects of inflation include Edward Wolff, "The Distributional Effects of the 1969–75 Inflation on Holdings of Household Wealth in the United States," *Review of Income and Wealth* 25 (June 1979); G. L. Bach and James Stephenson, "Inflation and the Redistribution of Wealth," *Review of Economics and Statistics* 61 (February 1974); William D. Nordhaus, "The Effects of Inflation on the Distribution of Economic Welfare," *Journal of Money, Credit, and Banking* 5 (February 1973); Edward C. Budd and David F. Seiders, "The Impact of Inflation on the Distribution of Income and Wealth," *American Economic Review* 61 (May 1971); Armen A. Alchian and Reuben A. Kessel, "Redistribution of Wealth through Inflation," *Science* 130 (September 4, 1959); G. L. Bach and

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by Charles Rist, that "price stability, just as much as much as price instability, gives rise to inequalities as between the citizens of one and the same country."[44]

If vigilance against inflation were the unambiguously universal optimal economic policy, then these distributional quibbles would be of only marginal interest—all groups seem to support bad policies that advance their own narrow interests. But as the economics becomes more ambiguous, the demand for a political explanation must increase. If the hypervigilant policy is but one plausible policy available from a larger menu, then it is likely that the distinct distributional effects of each policy choice, not its economic efficiency, explain the outcome.

This perspective can also explain the support for another pillar of legitimacy, the sanctity of central bank independence (CBI). Support for CBI derives from the need to guard against inflation. And increased CBI is, in fact, associated with lower rates of inflation. But while there is evidence that independent central banks are associated with lower inflation, there is no evidence that they are associated with enhanced economic performance.[45] This is surprising, since, for example, it was assumed that the greater credibility of independent central banks would cause disinflationary episodes to be both shorter and less costly. In fact, the opposite is true. "In direct contradiction" to the credibility hypothesis, "disinflation appears to be consistently *more* costly and no more rapid in countries with independent central banks." Rather than receiving a bonus, independent central banks "have to prove their toughness repeatedly, by being tough."[46]

But monetary policy can be too tight, and disinflationary policies are unambiguously associated with output losses. A policy of emphasizing inflation fighting and delegating responsibility for monetary policy to

Albert Ando, "The Redistributional Effects of Inflation," *Review of Economics and Statistics* 39 (February 1957); Reuben A. Kessel, "Inflation Caused Wealth Redistribution: A Test of a Hypothesis," *American Economic Review* 46 (March 1956); Hyman Sardy, "The Economic Impact of Inflation in Urban Areas," and Zbignew Landau, "Inflation in Poland after World War I," both in Neil Schumukler and Edward Marcus, eds., *Inflation through the Ages* (New York: Columbia University Press, 1983).

[44] Rist (fn. 35), 375.

[45] See Alberto Alesina and Lawrence H. Summers, "Central Bank Independence and Macroeconomic Performance: Some Comparative Evidence," *Journal of Money, Credit, and Banking* 25, no. 2 (1993); and Alex Cuckierman, "Central Bank Independence and Monetary Control," *Economic Journal* 104 (1994), 1440. For a good survey of this large literature, see Sylvester Eijffinger and Jakob De Haan, *The Political Economy of Central-Bank Independence*, Special Papers in International Economics 19 (Princeton: International Finance Section, Princeton University, 1996).

[46] Adam Posen, "Central Bank Independence and Disinflationary Credibility: A Missing Link?" *Federal Reserve Bank of New York Staff Reports* 1 (May 1995), 3, 13 (first quotes); Guy Dabelle and Stanley Fischer, "How Independent Should a Central Bank Be," in Jeffrey C. Fuhrer, ed., *Goals, Guidelines and Constraints Facing Monetary Policymakers* (Boston: Federal Reserve Bank of Boston, 1995), 205 (last quote); see also Eijffinger and De Haan (fn. 45), esp. 36, 38, 64.

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independent central bankers devoted to crushing inflation risks disregarding this potential threat to the real side of the economy.[47] In any event, the aggregate economic effects of the sole "legitimate" policy choice (CBI) are modest and ambiguous.

A focus on the real, microlevel effects of monetary phenomena clarifies the sharp politics, as opposed to the ambiguous economics, that is driving macroeconomic policy. Low inflation and perhaps more importantly the macroeconomic policies designed to assure that it remains very low benefit some groups in society at the expense of others. As Adam Posen has argued, low inflation is only sustainable if it has adequate political support. That support, he suggests, comes from numerous sources but especially from "one historically prominent interest group: the financial sector." The financial sector supports central bank independence "as a long-run means to price stability" and it could not be sustained "without that group's ongoing protection of its counter-inflationary activities."[48]

The idea that any threat of inflation must be suppressed is the only one that is legitimate in contemporary mainstream economic theory—and practice. That consensus helps sustain low inflation policies and, more importantly, serves to undermine policies that might deviate from the norm. The evidence supports the contention, however, that the aggregate economic consequences of most levels of inflation are modest, ambiguous, and certainly dwarfed by its differential effects.[49]

Capital Mobility: In Whose Interest?

If inflation fighting dominates macroeconomic policy at the domestic level, the deregulation of capital flows tops the international agenda. Once again, however, the same combination can be observed—self-

[47] It bears repeating that the ultimate resolution of the economic debate over optimal inflation policy is of small concern to students of politics, given the modest stakes. The purpose of this discussion is not to champion one policy over another but rather to illustrate that more than one policy is theoretically plausible, that the perception of legitimacy can be a crucial factor in determining which policy is chosen, and that the differential effects of each easily outweigh the difference in their aggregate economic consequences.

[48] Posen also shows a correlation between the strength of the financial sector and the degree of central bank independence. See Adam Posen, "Declarations Are Not Enough: Financial Sector Sources of Central Bank Independence," *NBER Macroeconomics Annual* 10 (1995), 254, 256, 264; idem, "Why Central Bank Independence Does Not Cause Low Inflation: There Is No Institutional Fix For Politics," in Richard O'Brien, ed., *Finance and the International Economy* 7 (1993), esp. 48.

[49] Studies that have explored the differential effects of low inflation and tight monetary policies include G. J. Santoni, "The Effects of Inflation on Commercial Banks," *Federal Reserve Bank of St. Louis Review* (March 1986); T. F. Cargill and M. M. Hutchison, "The Federal Reserve and the Bank of Japan," in Thomas Mayer, ed., *The Political Economy of American Monetary Policy* (Cambridge: Cambridge University Press, 1990), 172–73; Gerald Epstein and Juliet Schor, "Corporate Profitability as a Determinant of Restrictive Monetary Policy: Estimates for the Postwar United States," in Mayer;

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fulfilling legitimacy, ambiguous economics, and underappreciated politics. And if other economic policies—in this instance, some regulation of capital flows—are sound, plausible, and sustainable from an economic perspective (absent problems arising solely from the perception of legitimacy), then an explanation for the choice of one policy over another must be rooted in political analysis, rather than in economic theory.

The idea that capital flows should not be regulated is more than just self-fulfilling (though that is of course profoundly consequential); it is also the express policy of both powerful states like the United States and the international institutions that are supposed to oversee the smooth functioning of the global economy. The support for and the salience of the idea of freeing capital gathered momentum in the 1990s. In the wake of this trend, the International Monetary Fund embarked upon a fundamental revision of its charter, announcing plans in May 1997 to amend its constitution—the Articles of Agreement—"to make the promotion of capital account liberalization a specific purpose of the IMF and give it jurisdiction over capital movements."[50] This would be a dramatic change—in fact, the very *opposite* of what the founding fathers of the IMF intended. They thought that capital controls were necessary to assure the smooth functioning of an open international economy. Thus, the Bretton Woods era, the "golden age of capitalism," was a period of ubiquitous capital control. Now, however, the IMF has asserted that capital liberalization is the only legitimate path to economic efficiency, and it has explicitly proclaimed that "forces of globalization must be embraced." Its new policy has been repeatedly characterized as a proposition "to make unrestricted capital flows a condition of membership in the global economy."[51]

As with very low inflation, there are good deductive reasons to believe in the elimination of capital controls. Openness to capital inflows expands the resources available to the local economy, and the elimination of restrictions on capital outflows gives foreigners the confidence to invest. Not only are investors confident that they will be able to repatriate their profits, but states that allow unrestricted capital flows enjoy greater credibility: market actors assume that they are more likely to

Jeffry Frieden, "Monetary Populism in Nineteenth Century America: An Open Economy Interpretation," *Journal of Economic History* 57 (June 1997).

[50] "IMF Wins Mandate to Cover Capital Accounts," *IMF Survey* (May 12, 1997), 131–32.

[51] "Forces of Globalization Must Be Embraced," *IMF Survey* (May 26, 1997), 131; Darren Mcdermott and Leslie Lopez, "Malaysia Imposes Sweeping Currency Controls: Such Capital Restrictions Win Credence in Wake of Financial Turmoil," *Wall Street Journal*, September 2, 1998; G. Pierre Goad, "Acceptance of Capital Controls Is Spreading," *Asian Wall Street Journal*, September 2, 1998, "condition of membership" quotes.

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follow "sound" policies, because if they failed to do so, they would be subject to hemorrhaging of both foreign and domestic capital. More generally, free capital seems to follow the logic of free trade—few deny that an open market leads to goods results in a more efficient allocation of resources, expanded consumption choices, and a host of other benefits such as the discipline imposed by international competition.

But again, as with inflation, there are competing deductive arguments that suggest that some positive level of capital control is optimal for achieving economic efficiency.[52] The free flow of capital differs in important ways from the free flow of goods, just like Cohen's monetary oligopolists differ from oligopoly producers in the real economy. Two attributes make capital quite distinct from most real goods. First, contemporary technology allows investors to move huge amounts of money almost instantaneously and at very little cost. Second, to an important extent, financial assets are worth what people think they are worth. Given these elements, fears regarding what other people are thinking can cause herding behavior, unleashing financial stampedes with economic consequences that veer far from the path suggested by any reading of the economic "fundamentals."

Additionally, in a world of perfectly mobile capital, investors can scan the globe for the best rates of return, and this creates pressure for conformity across countries' macroeconomic policies. But it is highly unlikely that all states should be pursuing the same macroeconomic policies at any given moment. On the contrary, because states face diverse economic conditions, they need to tailor their economic policies accordingly. But without any restrictions on capital, governments that deviate from the international norm, even when pursuing policies appropriate for local needs, are "punished" by capital flight and are often forced to abandon or even reverse such policies.

In this instance, competing deductive arguments have not been followed by a trove of empirical studies ready for mining. Jagdish Bhagwati, noted champion of free trade, recently took many of his fellow economists to task for simply assuming the case for unregulated capital. Proponents of free trade, he observes, have provided mountains of evidence to support their claims; the supporters of free capital have not. If fact, he concludes, "the weight of evidence and the force of logic point

[52] Once again, it is important to note the qualified nature of this argument. The competing argument is not that capital flows are bad but rather that completely deregulated capital would lead to a suboptimally high level of flows.

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in the opposite direction, toward restraints on capital flows."[53] This challenge is only reinforced by the recent study of Dani Rodrik, whose analysis from a sample of one hundred countries finds "no evidence that countries without capital controls have grown faster, invested more, or experienced lower inflation."[54]

Skepticism about the benefits of unlimited capital mobility would appear to make more sense with the unexpected spread and depth of the Asian financial crisis. Moreover, efforts by many states to defend their currencies in an environment of mobile capital required deflationary measures that only exacerbated economic distress, while countries that had retained their capital controls were largely spared. And the crisis was, to say the least, unanticipated. In September 1996 the IMF asserted that "international capital markets appear to have become more resilient and are less likely to be a source of disturbances."[55] As late as May 1997 the managing director of the IMF remarked that "global economic prospects warranted 'rational exuberance.'" In addition, economic prospects were "bright" and "overheating pressures have abated in many emerging market economies, especially in Asia—where growth has stayed strong for several years."[56]

But the IMF's retrospective analyses of the crisis make clear that it has not been shaken in its beliefs but remains focused on the domestic sources of the crisis and highly suspicious of any forms of capital control.[57] However sincerely those ideas may be held, given the muddled message yielded by the economic arguments, greater attention must be

[53] Jagdish Bhagwati, "The Capital Myth," *Foreign Affairs* 77 (May–June 1998), 9, 12. For further skepticism and qualifications, see Richard N. Cooper, "Should Capital Controls Be Banished?" *Brookings Papers on Economic Activity* 99:1 (1999).

[54] Dani Rodrik, "Who Needs Capital Account Convertibility?" in *Should the IMF Pursue Capital Account Convertibility?* Essays in International Finance, no. 207 (Princeton: International Finance Section, Princeton University, May 1998), 61.

[55] *IMF Survey* (September 23, 1996), 294. Under the headline "International Capital Markets Charting a Steadier Course," the fund also noted that "although the scale of financial activity continues to grow, market participants—including high-risk high-return investment funds—are more disciplined, cautious, and sensitive to market fundamentals" (p. 293).

[56] *IMF Survey* (May 12, 1997), 129–30.

[57] International Monetary Fund, *International Capital Markets: Developments, Prospects, and Key Policy Issues* (Washington, D.C.: IMF, September 1998), esp. 6, 11, 57, 63, 73, 148–50; see also International Monetary Fund, *World Economic Outlook: Financial Turbulence and the World Economy* (Washington, D.C.: IMF, October 1998), esp. 6–18, 101–2. It should be noted, however, that in the wake of the crisis the World Bank has been willing at least to address the issue of the possible benefits of some control over short-term capital flows. See World Bank, *Global Economic Prospects and the Developing Countries, 1998–99: Beyond Financial Crisis* (Washington, D.C.: World Bank, 1999), esp. xi-xii, xxi, 4, 123–24, 128, 142–52; see also World Bank, *East Asia: The Road to Recovery* (Washington, D.C.: World Bank, 1998), esp. 9–10, 16, 34.

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paid to the prospect that interest rather than efficiency is behind the drive for financial liberalization. States and state-led institutions are responsible for global financial deregulation.[58] And according to at least one report, there are those in Washington who have "quietly expressed the hope" that Malaysia's response to the financial crisis, the introduction of capital controls, "would fail so spectacularly that the smoldering ruins of the Malaysian economy would act as a caution to other countries."[59] Surely the narrow interests of individual states or influential groups within those states are at stake. The modest and ambiguous aggregate gains to be reaped from perfect global capital mobility cannot account for such passions.

Although they approach the issue from distinct, even competing perspectives, Cohen and Strange agree that the contours of global economy have been transformed by the ascendance of money, and these changes have basic and important political consequences. IPE scholars at the start of the twenty-first century will be called upon increasingly to come to grips with these issues. The resulting studies will undoubtedly trace their points of departure, questions of origin, and analytical frameworks back to either *The Geography of Money* or *Mad Money*, or perhaps even both. They will also necessarily confront the unique interconnections between the ideas, material interests, and institutions associated with the management of money. From these links derive many of the riddles and mysteries that animate these books and that have plagued and energized the study of money throughout history: That money is what people think it is. That apparently technical debates are inescapably political. And that those politics, more than the underlying economics, can best explain the shape of the monetary landscape.

[58] See Eric Helleiner, *States and the Reemergence of Global Finance* (Ithaca, N.Y.: Cornell University Press, 1994).

[59] David E. Sanger, "Gaining Currency: The Invisible Hand's New Strong Arm," *New York Times*, September 9, 1998.

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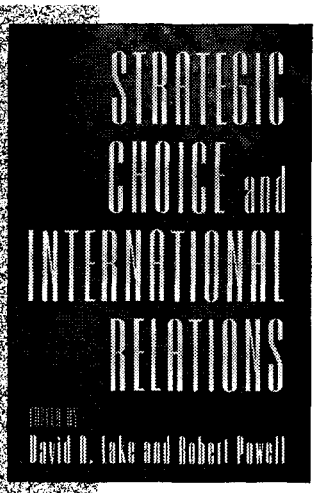

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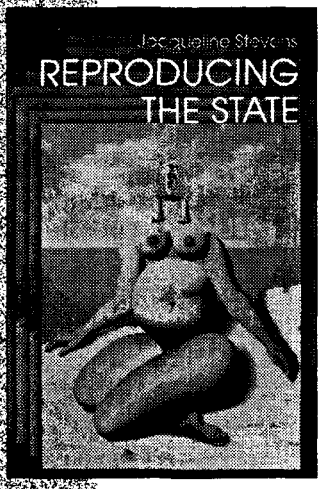

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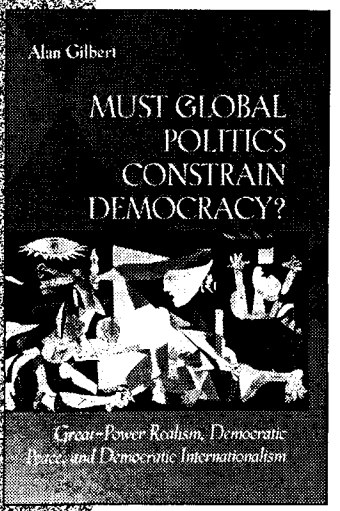

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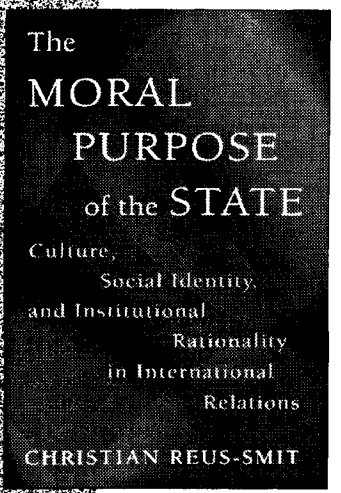

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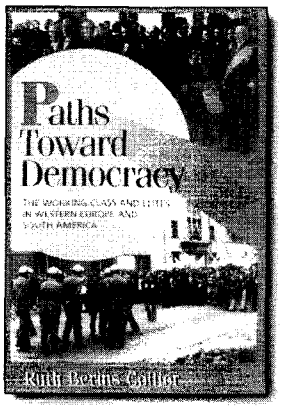

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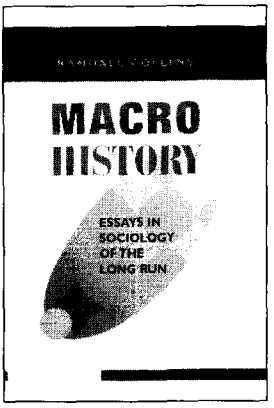

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